



## Notes to the Financial Statements

(Prepared under PRC Accounting Rules and Regulations)

### 1 BACKGROUND OF THE COMPANY

China Southern Airlines Company Limited (the “Company”) and its subsidiary companies (collectively the “Group”) are principally engaged in the provision of domestic, Hong Kong regional and international passenger, cargo and mail airline services, with flights operating primarily from the new Guangzhou Baiyun International Airport, which is both the main hub of the Group’s route network and the location of its corporate headquarters.

The Company is a joint stock limited company established by China Southern Air Holding Company (“CSAHC”) pursuant to an approval document Ti Gai Sheng 【1994】 No. 139 from the State Commission for Economic Restructuring of the Peoples’ Republic of China (“PRC”). CSAHC injected airline-related assets and liabilities as at 1 January, 1994 into the Company in exchange for 2,200,000,000 domestic shares with a par value of RMB1.00 each. The Company was established on 25 March, 1995, and took over the control of the airline business from CSAHC since that date.

Pursuant to an approval document Zheng Wei Fa 【1997】 No. 33 from the China Securities Regulatory Commission, the Company listed its 1,174,178,000 H Shares on both the Stock Exchange of Hong Kong Limited and the New York Stock Exchange in July 1997.

Pursuant to an extraordinary general meeting of shareholders held on 21 May, 2002, a resolution was passed authorising the Company to issue not more than 1,000,000,000 A shares of par value of RMB1.00 each. Pursuant to an approval document (2003) No. 70 from the China Securities Regulatory Commission, the Company issued and listed its 1,000,000,000 A shares with a par value of RMB1.00 each on the Shanghai Stock Exchange in July 2003.

On 13 March, 2003, the Company obtained an approval certificate Wai Jing Mao Zi Yi 【2003】 No. 273 from the Ministry of Foreign Trade & Economic Cooperation to change to a permanent joint stock limited company with foreign investments and obtained the business licence dated 17 October, 2003 (Qi Gu Guo Fu Zi No. 000995) issued by the State Administration of Industry and Commerce of the PRC.

Pursuant to a sale and purchase agreement dated 12 November, 2004 between the Company, CSAHC, China Northern Airlines Company (“CNA”) and Xinjiang Airlines Company (“XJA”) which was approved by the Company’s shareholders in an extraordinary general meeting held on 31 December, 2004, the Company acquired the airline operations and certain related assets of CNA and XJA with effect from 31 December, 2004 (the “CNA/XJA Acquisitions”). The consideration payable for the CNA/XJA Acquisitions amounting to RMB15,398 million was determined based on the fair value of the acquired assets. Such consideration was partly satisfied by assumption of debts and liabilities of CNA and XJA totalling RMB13,439 million outstanding as at 31 December, 2004 and the remaining balance of RMB1,959 million will be satisfied in cash.

## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 2 SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies adopted by the Group in the preparation of the financial statements conform to the Accounting Standards for Business Enterprises and the "Accounting Regulations for Business Enterprises" and other relevant regulations issued by the Ministry of Finance ("MOF"). Pursuant to a notice Cai Kuai (2003) No.18 from the MOF, the Group adopts the "Accounting Method for Civil Aviation Enterprises" since 1 January, 2003. The significant accounting policies adopted in the preparation of these financial statements are set out below:

#### (a) Accounting year

The accounting year of the Group is from 1 January to 31 December.

#### (b) Basis of consolidation

The consolidated financial statements have been prepared in accordance with "Accounting Regulations for Business Enterprises" and Cai Kuai Zi 【1995】 No.11 "Provisional regulations on consolidated financial statements" issued by the MOF.

The consolidated financial statements include the financial statements of the Company and all of its principal subsidiaries. Subsidiaries are those entities in which the Company has more than 50% equity interest or those entities controlled by the Company. The consolidated income statement of the Company only includes the results of the subsidiaries during the period when the Company has more than 50% equity interest, or when the Company does not have more than 50% equity interest, but has control over those entities. The effect of minority interests on equity and profit/loss attributable to minority interests are separately shown in the consolidated financial statements. For those subsidiaries whose assets and results of operations are not significant and have no significant effect on the Group's consolidated financial statements, the Company does not consolidate these subsidiaries.

Where the accounting policies adopted by subsidiaries are different from the policies adopted by the Company, the financial statements of the subsidiaries have been adjusted in accordance with the accounting policies adopted by the Company on consolidation. All significant intercompany balances and transactions, and any unrealised gains arising from inter-company transactions, have been eliminated on consolidation.

For those jointly controlled entities which the Company has joint control with other investors under contractual arrangements, the Company consolidates their assets, liabilities, revenues, costs and expenses based on the proportionate consolidation method according to its percentage of equity interest holding in those entities in the consolidated financial statements.

#### (c) Basis of preparation

The financial statements have been prepared on an accrual basis under the historical costs convention, unless otherwise stated.

#### (d) Reporting currency

The financial statements are prepared in Renminbi.



## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 2 SIGNIFICANT ACCOUNTING POLICIES (cont'd)

#### (e) Translation of foreign currencies

Foreign currency transactions during the year are translated into Renminbi at the exchange rates quoted by the People's Bank of China ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into Renminbi at the exchange rates quoted by the People's Bank of China ruling at the balance sheet date. Exchange gains and losses on foreign currency translation, except for the exchange gains and losses directly relating to the construction of fixed assets (see note 2(j)) below, are dealt with in the income statement.

#### (f) Cash equivalents

Cash equivalents are short-term and highly liquid investments which are readily convertible into known amounts of cash and are subject to an insignificant risk of change in value.

#### (g) Provision for bad and doubtful debts

Trade accounts receivable showing signs of uncollectibility are identified individually and allowance is then made based on the probability of being uncollectible. In respect of trade accounts receivable showing no sign of uncollectibility, allowance is made with reference to the ageing analysis and management's estimation based on past experience.

Allowances for other receivables are made based on the nature of the receivables and estimation of the corresponding collectibility risk.

#### (h) Inventories

Inventories, which consist primarily of expendable spare parts and consumables, are carried at the lower of cost and net realisable value. Inventories are measured at their actual cost upon acquisition. The cost of inventories is calculated using the weighted average method. Any excess of the cost over the net realisable value of each class of inventories is recognised as a provision for diminution in value of inventories. Net realisable value is determined based on amount recoverable in the normal course of business after the balance sheet date or estimates made by management based on market conditions. Inventories are recorded using the perpetual stocking method.

Inventories are amortised in full when issued for use.

#### (i) Investments

##### (i) Short-term investments

Short-term investments are carried at the lower of cost and market value. The cost of a short-term investment is the total price paid on acquisition of the investment. However, it does not include cash dividends which have been declared but which are unpaid or unpaid interest on debentures which was due at the time of acquisition.

## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 2 SIGNIFICANT ACCOUNTING POLICIES (cont'd)

#### (i) Investments (cont'd)

##### (i) *Short-term investments (cont'd)*

Provision for diminution in value is made on an item-by-item basis for any shortfall of the market value over the cost of material short-term investments. Provision for diminution in value is also made for any shortfall of the market value over the cost of other short-term investments on an aggregate basis by each category of the investments.

With the exception of cash dividends which have been declared but which are unpaid at the time of acquisition and interest on debentures which is due but not yet paid at the time of acquisition, cash dividends and interest are set off against the carrying amount of the short-term investments when received by the Company. Upon the disposal of short-term investments, the difference between the carrying amount of the short-term investments and the proceeds received is recognised in the income statement for the current period.

##### (ii) *Long-term equity investments*

Where the Company has the power to control, jointly control or exercise significant influence over an investee enterprise, the investment is accounted for under the equity method of accounting whereby the investment is initially recorded at cost and adjusted thereafter for any post acquisition change in the Company's share of the investors' equity in the investee enterprise.

Equity investment difference, which is the difference between the initial investment cost and the Company's share of investors' equity in the investee enterprise, is accounted for as follows:

- Any excess of the initial investment cost over the Company's share of the investors' equity in the investee enterprise is amortised on a straight-line basis. The amortisation period is determined according to the investment period as stipulated in the relevant agreement, or 10 years if the investment period is not specified in the agreement. The unamortised balance is included in long-term equity investments at the year end.
- Any shortfall of the initial investment cost over the Company's share of the investors' equity in the investee enterprise is amortised on a straight-line basis over 10 years if the investment was acquired before the MOF's issuance of the "Questions and Answers on Implementing Accounting Regulations for Business Enterprises and Related Accounting Standards (II)" (Cai Kuai 【2003】 No. 10). The unamortised balance is included in long-term equity investments at the year end. Any shortfalls are recognised in the "Capital surplus – reserve for equity investment" if the investment is acquired after the issuance of Cai Kuai 【2003】 No. 10.

Where the Company does not control, jointly control or exercise significant influence over an investee enterprise, the investment is accounted for under the cost method, stating it at the initial investment cost. Investment income is recognised when the investee enterprise declares a cash dividend or distributes profits.

Upon the disposal or transfer of long-term equity investments, the difference between the proceeds received and the carrying amount of the investments is recognised in the income statement.

The Group makes provision for impairment losses on long-term equity investments (see note 2(n)).



## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 2 SIGNIFICANT ACCOUNTING POLICIES (cont'd)

#### (j) Fixed assets and construction in progress

Fixed assets represent the assets held by the Group for rendering services and administrative purposes with useful lives over 1 year and comparatively high unit values.

Fixed assets are stated in the balance sheet at cost or revalued amount less accumulated depreciation and impairment losses (see note 2(n)). Construction in progress are stated in the balance sheet at cost less impairment losses (see note 2(n)). Valuation is carried out in accordance with the relevant rules and regulations in the PRC and the assets are adjusted to the revalued amounts accordingly.

All direct and indirect costs related to the acquisition or construction of fixed assets, incurred before the assets are ready for their intended uses, are capitalised as construction in progress. Those costs include borrowing costs, which include foreign exchange differences, on specific borrowings for the construction of the fixed assets during the construction period.

Construction in progress is transferred to fixed assets when the asset is ready for its intended use. No depreciation is provided on construction in progress.

Pursuant to an approval document Cai Kuai Han 【2004】 No. 39 issued by the MOF, the Group accounts for high value rotables as fixed assets.

Depreciation is provided to write off the cost of fixed assets over their estimated useful lives on a straight-line basis, after taking into account their estimated residual values. The respective annual depreciation rates for fixed assets are as follows:

	Annual depreciation rate
Owned and leased aircraft	4.75%-6.33%
Other flight equipment:	
– Jet engines	6.47%-12.13%
– Others, including high value rotables	6.67%-12.5%
Buildings	2.5%-6.67%
Machinery and equipment	9.7%-19.4%
Motor vehicles	16.17%

Land use rights are stated in the balance sheet at cost or revalued amount less accumulated depreciation and impairment losses (see note 2(n)), and are amortised on a straight-line basis over the period for land use rights.

#### (k) Leased assets

Leases are classified into finance leases and operating leases. A finance lease is a lease that transfers substantially all the risks and rewards incidental to ownership of a leased asset to the lessee, whether or not the legal title to the asset is eventually transferred. An operating lease is a lease other than a finance lease.

## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 2 SIGNIFICANT ACCOUNTING POLICIES (cont'd)

#### (k) Leased assets (cont'd)

##### (i) *Assets acquired under finance leases*

Fixed assets acquired by way of finance leases are stated under fixed assets at an amount equal to the lower of their original carrying amount in the books of the legal owner (the lessor) and the present value of the minimum lease payments at the inception of the lease. Depreciation of leased assets is calculated using the straight-line method.

If there is no reasonable certainty that the Group will obtain ownership of the leased assets at the end of the lease term, the leased assets are depreciated over the shorter of the lease term or their estimated useful lives. If there is reasonable certainty that the Group will obtain ownership of the leased assets at the end of the lease term, the leased assets are depreciated over their estimated useful lives.

At the inception of the lease, the minimum lease payments are recorded as payables under finance leases. The difference between the value of the leased assets and the minimum lease payments is recognised as unrecognised finance charges under finance leases. At the year end, payables under finance leases are netted against the unrecognised finance charges under finance leases and included in long-term payables in the balance sheet.

Unrecognised finance charges under finance leases are amortised using the effective interest rate method over the lease term.

The Group makes provision for impairment losses on assets acquired under finance leases (see note 2(n)).

##### (ii) *Operating lease charges*

Rental payments under operating leases are recognised as expenses on a straight-line basis over the lease term. Contingent rental payments are recognised as expenses in the accounting period in which they are incurred.

#### (l) Intangible assets

Intangible assets are stated in the balance sheet at cost less accumulated amortisation and impairment losses (see note 2(n)). The cost of the intangible assets is amortised on a straight-line basis over the contracted beneficial period or the effective period stipulated by law, whichever is shorter. Where the useful life is not stipulated by the contract or law, the amortisation is over a period of 10 years.

#### (m) Long-term deferred expenses

Custom duties and other direct costs incurred in relation to modifying, introducing and certifying certain operating leased aircraft are deferred and amortised on a straight-line basis over the terms of the related leases.



## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 2 SIGNIFICANT ACCOUNTING POLICIES (cont'd)

#### (n) Provision for impairment

The carrying amounts of assets (including designated loans receivable, long-term investments, fixed assets, construction in progress, intangible assets and other assets) are reviewed regularly at each balance sheet date to determine whether their recoverable amounts have declined below their carrying amounts. Assets are tested for impairment whenever events or changes in circumstances indicate that their recorded carrying amounts may not be recoverable. When such a decline has occurred, the carrying amount is reduced to the recoverable amount. The amount by which the carrying amount is reduced is the impairment loss.

The recoverable amount is the higher of the net selling price and the present value of the estimated future cash flows arising from the continuous use of the asset and from the disposal of the asset at the end of its useful life.

Provision for impairment loss is calculated on an item by item basis and recognised as an expense in the income statement. However, when a shortfall of the initial investment cost over the Group's share of the investors' equity of the investee enterprise has been credited to the capital reserve, any impairment losses for long-term equity investment are firstly set off against the difference initially recognised in the capital reserve relating to the investment and any excess impairment losses are then recognised in the income statement.

If there is an indication that there has been a favourable change in the estimates used to determine the recoverable amount and as a result the estimated recoverable amount is greater than the carrying amount of the asset, the impairment loss recognised in prior years is reversed. Reversals of impairment losses are recognised in the income statement. Impairment losses are reversed to the extent of the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years. In respect of the reversal of an impairment loss for a long-term equity investment, the reversal starts with the impairment losses that had previously been recognised in the income statement and then the impairment losses that had been charged to the capital reserve.

#### (o) Income tax

Income tax is recognised using the tax effect accounting method. Income tax for the year comprises current tax paid and payable and movement of deferred tax assets and liabilities.

Current tax is calculated at the applicable tax rate on taxable income.

Deferred tax is provided using the liability method for the differences between the accounting profits and the taxable profits arising from the timing differences in recognising income, expenses or losses between the accounting and tax regulations. When the tax rate changes or a new type of tax is levied, adjustments are made to the amounts originally recognised for the timing differences under the liability method. The current tax rates are used in arriving at the reversal amounts when the timing differences are reversed.

Deferred tax assets arising from tax losses, which are expected to be utilised against future taxable profits, are set off against the deferred tax liabilities (only for the same taxpayer within the same jurisdiction). When it is not probable that the tax benefits of deferred tax assets will be realised, the deferred tax assets are reduced to the extent that the related tax benefits are expected to be realised.

## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 2 SIGNIFICANT ACCOUNTING POLICIES (cont'd)

#### (p) Provisions and contingent liabilities

Provisions are recognised when the Group has a present obligation as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligations and a reliable estimate can be made.

Where it is not probable that the settlement of the above obligation will cause an outflow of economic benefits, or the amount of the outflow cannot be estimated reliably, the obligation is disclosed as a contingent liability.

#### (q) Revenue recognition

Provided it is probable that the economic benefits will flow to the Group and the revenue and costs can be measured reliably, revenue is recognised in the income statement as follows:

- (i) Passenger, cargo and mail revenues are recognised when the transportation is provided. Ticket sales for transportation not yet provided are included in current liabilities as sales in advance of carriage;
- (ii) Revenues from airline-related businesses are recognised when the relevant services are rendered;
- (iii) Interest income is recognised on a time proportion basis according to the principal outstanding and the applicable rate; and
- (iv) Dividend income is recognised when the Group's right to receive the dividend is established.

#### (r) Traffic commissions

Traffic commissions are expensed when the transportation is provided and the related revenue is recognised. Traffic commissions for transportation not yet provided are recorded on the balance sheet as a prepaid expense.

#### (s) Borrowing costs

Borrowing costs incurred on specific borrowings for the construction of fixed assets are capitalised into the cost of the fixed assets during the construction period until the fixed assets are ready for their intended uses.

Except for the above borrowing costs, other borrowing costs are recognised as financial expenses in the income statement when incurred.

#### (t) Repairs and maintenance expenses

Routine maintenance and repairs and overhauls in respect of owned aircraft and aircraft held under finance leases are expensed as and when incurred. In respect of aircraft held under operating leases, a provision is made over the lease term for the estimated cost of overhauls that are required to be performed on the related aircraft prior to their return to the lessors.





## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 2 SIGNIFICANT ACCOUNTING POLICIES (cont'd)

#### (u) Dividends

Dividends appropriated to shareholders are recognised in the income statement and profit appropriation statement when approved. Dividends proposed or approved after the balance sheet date but before the date on which the financial statements are authorised for issue are separately disclosed under shareholders' equity in the balance sheet.

#### (v) Retirement benefits

Pursuant to the relevant laws and regulations in the PRC, the Group has joined certain defined contribution retirement schemes for the employees arranged by the governmental organisations. The Group makes contributions to the retirement schemes at the applicable rates based on the employees' salaries. The required contributions under the retirement schemes are charged to the income statement when they are due.

#### (w) Frequent flyer award programmes

The Group maintains two frequent flyer award programmes, namely, the China Southern Airlines Sky Pearl Club and Egret Mileage Plus, which provide travel awards to members based on accumulated mileage. The estimated incremental cost of providing free travel is recognised as an expense and accrued as a current liability as members accumulate mileage. As members redeem awards or their entitlements expire, the incremental cost liability is reduced accordingly, to reflect the acquittal of the outstanding obligations.

Revenue from mileage sales to third parties under the frequent flyer award programmes is recognised when the related transportation services are provided.

#### (x) Related parties

If the Group has the power, directly or indirectly, to control, jointly control or exercise significant influence over another party, or vice versa, or where the Group and one or more parties are subject to common control from another party, they are considered to be related parties. Related parties may be individuals or enterprises.

## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 3 TAXATION

#### (a) Major taxes applicable to the rendering of services by the Group are as follows:

Type of taxes	Tax rates	Basis of tax
Business tax	3% or 5%	Traffic revenue, ground services income and commission income. All inbound international and Hong Kong regional flights are exempted from business tax
City construction tax	7%	Business tax
Education surcharge	3%	Business tax

Pursuant to approval documents Cai Shui 【2003】 No. 113 and Cai Shui 【2003】 No. 227 jointly issued by the MOF and State Tax Bureau, passenger revenue from airline operations was exempted from business tax, city construction tax and education surcharge during the period from 1 May, 2003 to 31 December, 2003.

As mentioned in Note 1, the Company has become a foreign investment enterprise. Pursuant to Article 5 of 【1985】 Cai Sui Zi No. 069 “Ministry of Finance’s Rules on Certain Questions on City Construction Tax Provisional Regulations” and Article 2 of 【1994】 No. 23 “State Council Supplementary Notice on Exemption of Education Surcharge”, the Company is exempted from city construction tax and education surcharge since 1 October, 2003.

#### (b) Income tax

The income tax rate applicable to the Company for the period from 1 January, 2003 to 30 September, 2003 was 33%. Commencing 1 October, 2003 the applicable tax rate is 15%.

On 17 October, 2003, the Company’s registered address was moved to Guangzhou Economic & Technology Development Zone. In accordance with the Rules and Regulations for Implementation of Income Tax for Foreign Investment Enterprises and Foreign Enterprises of the PRC and a taxation approval document “Guangzhou Municipal State Tax Bureau Suo De Shui Zi Que 020043”, the Company is entitled to enjoy the preferential tax policy implemented in the Guangzhou Economic & Technology Development Zone effective 1 October, 2003. As a result, the Company’s income tax rate has been changed to 15% beginning from that date.

In respect of the Group’s overseas airline activities, the Group has either obtained exemptions from overseas taxation pursuant to the bilateral aviation agreements between the overseas governments and PRC government, or has sustained tax losses in these overseas jurisdictions. Accordingly, no provision for overseas tax has been made for the year.



## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 3 TAXATION (cont'd)

#### (b) Income tax (cont'd)

Certain subsidiaries and jointly controlled entities of the Company have been granted with tax concessions which are set out below:

Name of subsidiaries	Applicable tax rate	Reasons for granting concession
Zhuhai Airlines Company Limited	15%	Operates in a special economic zone and accordingly enjoys a reduced income tax rate pursuant to documents Cai Shui Zi (86) No. 122 and Cai Shui Zi (87) No. 115.
Southern Airlines (Group) Shantou Airlines Company Limited	15%	Ditto
Xiamen Airlines Company Limited	15%	Ditto
Guangzhou Nanland Air Catering Company Limited	27%	Pursuant to Rules and Regulations for Implementation of Income Tax for Foreign Investment Enterprises and Foreign Enterprises of the PRC, the applicable state income tax rate is 24% and local income tax rate is 3%.
Zhuhai Xiang Yi Aviation Technology Company Limited	7.5%	Pursuant to Zhu Guo Shui Hang 【2003】 94 issued by Zhuhai Municipal State Tax Bureau, the entity enjoys a reduced income tax rate.
<b>Name of jointly controlled entities</b>		
Guangzhou Aircraft Maintenance Engineering Company Limited	15%	Pursuant to Sui Guo Shui Zhi Fa 【2001】 No. 77 issued by Guangzhou Municipal State Tax Bureau, the applicable income tax rate is 15% since 2000.
MTU Maintenance Zhuhai Co. Ltd.	15%	Pursuant to Rules and Regulations for Implementation of Income Tax for Foreign Investment Enterprises and Foreign Enterprises of the PRC, the applicable income tax rate is 15%.

## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 3 TAXATION (cont'd)

#### (c) Taxes payable

	The Group		The Company	
	2004 RMB million	2003 RMB million	2004 RMB million	2003 RMB million
Enterprise income tax	41	46	–	–
Business tax	239	25	127	3
City construction tax	16	2	8	1
Value added tax	15	13	–	–
Other	13	16	6	7
<b>Total</b>	<b>324</b>	<b>102</b>	<b>141</b>	<b>11</b>

### 4 CAAC INFRASTRUCTURE DEVELOPMENT FUND

Contributions to the CAAC infrastructure development fund were levied at a certain percentage on traffic revenue and payable to the Civil Aviation Administration of China (“CAAC”) on or before 31 March, 2004. Pursuant to the regulation, Cai Zhong Zi 【1999】 No. 11 jointly issued by the MOF and the State Development Commission, contributions to the CAAC infrastructure development Fund was levied at 5% and 2% on domestic traffic revenue and international/Hong Kong regional traffic revenue respectively.

Pursuant to the approval documents Cai Zong Ming Dian No. 1 and Ming Hang Ji No. 2026, the Group was exempted from paying any contributions to the CAAC infrastructure development fund during the period from 1 May, 2003 to 31 March, 2004.

Pursuant to the Minhang Gui Cai Fa 【2004】 No. 94, commencing 1 April, 2004, contributions to the CAAC infrastructure development fund are payable based on the notice 【2004】 No. 38 issued by MOF. Contributions to the CAAC infrastructure development fund are now calculated based on the route type, flight loading, flight distance and prescribed charge rates and form part of the cost of principal operations.



Notes to the Financial Statements (Cont'd)  
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5 CASH AND CASH EQUIVALENTS

	The Group				The Company			
	2004		2003		2004		2003	
	Original currency million	RMB million	Original currency million	RMB million	Original currency million	RMB million	Original currency million	RMB million
Cash in hand								
Renminbi		6		1	6			1
US Dollars	-	4	-	3	1		-	2
Other currencies	-	3	-	1	1		-	1
		<b>13</b>		<b>5</b>	<b>8</b>			<b>4</b>
Cash at bank								
Renminbi		2,084		1,383	1,233			624
US Dollars	40	334	31	261	41	342	18	148
HK Dollars	83	88	10	11	24	25	4	4
Japanese Yen	1,275	101	537	42	1,242	99	537	42
Singapore Dollars	2	8	2	12	2	8	2	12
Thai Bahts	45	10	55	11	38	8	52	11
Malayshian Ringgit	32	70	20	44	31	68	18	40
Euro	3	38	2	20	3	36	2	18
Korean Won	6,835	54	13,770	95	6,329	50	13,472	93
Vietnam Dong	28,588	15	41,531	22	28,588	15	41,531	22
Australian Dollars	6	40	6	35	5	35	5	32
Other currencies	-	13	-	9	13		-	9
		<b>2,855</b>		<b>1,945</b>	<b>1,932</b>			<b>1,055</b>
Deposits in financial institution								
Renminbi		406		371	362			346
		<b>406</b>		<b>371</b>	<b>362</b>			<b>346</b>
Total		<b>3,274</b>		<b>2,321</b>	<b>2,302</b>			<b>1,405</b>

## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 5 CASH AND CASH EQUIVALENTS (cont'd)

Deposits in financial institution represent deposits with Southern Airlines Group Finance Company Limited ("SA Finance"), a PRC authorised financial institution controlled by CSAHC and an associated company of the Group (Note 46).

The Group does not have any collateralised or frozen bank deposits as at 31 December, 2004. As at 31 December, 2004, the Group's overseas bank deposits amounted to RMB388 million (2003: RMB343 million). These overseas bank deposits are not subject to any significant risk of uncollectibility.

The above cash, bank deposits and deposits with financial institution denominated in foreign currencies are translated into Renminbi at the following exchange rates:

	2004	2003
US Dollar	8.2765	8.2767
HK Dollar	1.0637	1.0657
Japanese Yen	0.079701	0.077263
Singapore Dollar	5.0550	4.8587
Thai Bahts	0.2122	0.2087
Malaysian Ringgit	2.177	2.172
Euro	11.2627	10.3383
Korean Won	0.007900	0.006925
Vietnam Dong	0.0005247	0.0005291
Australian Dollar	6.4428	6.2013

Note: Balances dominated in foreign currencies in these financial statements are translated into Renminbi at the above rates, unless otherwise stated.

### 6 SHORT-TERM INVESTMENTS

#### The Group

	Balance at the beginning of the year RMB million	Additions during the year RMB million	Disposals during the year RMB million	Balance at the end of the year RMB million
Equity investment				
– Investments in stocks	–	509	–	509
Debt investments				
– Government bonds	–	160	–	160
Total	–	669	–	669



## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 6 SHORT-TERM INVESTMENTS (cont'd)

#### The Company

	Balance at the beginning of the year RMB million	Additions during the year RMB million	Disposals during the year RMB million	Balance at the end of the year RMB million
Equity investment				
– Investments in stocks	–	487	–	487

The market value, if available, of the above short-term investments as at the year end are as follows:

#### The Group

	2004		2003	
	Carrying amount RMB million	Market value RMB million	Carrying amount RMB million	Market value RMB million
Investments in stocks	509	529	–	–
Debt investments	160	160	–	–

#### The Company

	2004		2003	
	Carrying amount RMB million	Market value RMB million	Carrying amount RMB million	Market value RMB million
Investments in stocks	487	502	–	–

The market value information is extracted from Shanghai Stock Exchange, Shenzhen Stock Exchange and chinabond.com.cn.

In 2004, the Company and an independent third party jointly appointed Centergate Securities Company Limited to manage and invest asset of the Company and the independent third party of RMB500 million and RMB75 million respectively. The entrusted investment consist mainly of investment securities. The entrusting period is from 27 July, 2004 to 26 July, 2005. According to the contract, the independent third party has the responsibility to ensure the Company has a reasonable return on investment, and avoid any loss from investment.

As at 31 December, 2004, there were no material restrictions on the realisation of the short-term investments of the Group and the Company.

## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

## 7 TRADE RECEIVABLES

	The Group		The Company	
	2004 RMB million	2003 RMB million	2004 RMB million	2003 RMB million
Trade receivables	1,687	962	1,379	740
Less: Provision for bad and doubtful debts	95	70	82	57
	1,592	892	1,297	683

The ageing analysis of trade receivables is as follows:

## The Group

	2004				2003			
	Amount RMB million	% of total trade receivables %	Bad debt provision RMB million	% of bad debt provision %	Amount RMB million	% of total trade receivables %	Bad debt provision RMB million	% of bad debt provision %
Within 1 year	1,576	93.4%	5	0.3%	898	93.2%	6	0.5%
Over 1 year but within 2 years	14	0.8%	9	64.3%	42	4.4%	42	100.0%
Over 2 years but within 3 years	25	1.5%	9	36.0%	14	1.5%	14	100.0%
Over 3 years	72	4.3%	72	100.0%	8	0.9%	8	100.0%
Total	1,687	100.0%	95	5.6%	962	100.0%	70	7.3%

## The Company

	2004				2003			
	Amount RMB million	% of total trade receivables %	Bad debt provision RMB million	% of bad debt provision %	Amount RMB million	% of total trade receivables %	Bad debt provision RMB million	% of bad debt provision %
Within 1 year	1,282	92.9%	6	0.5%	685	92.5%	2	0.3%
Over 1 year but within 2 years	8	0.6%	3	37.5%	42	5.7%	42	100.0%
Over 2 years but within 3 years	23	1.7%	7	30.4%	8	1.1%	8	100.0%
Over 3 years	66	4.8%	66	100.0%	5	0.7%	5	100.0%
Total	1,379	100.0%	82	5.9%	740	100.0%	57	7.7%





## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 7 TRADE RECEIVABLES (cont'd)

Provision for bad and doubtful debts is analysed as follows:

	The Group		The Company	
	2004 RMB million	2003 RMB million	2004 RMB million	2003 RMB million
Balance as at 1 January,	70	60	57	29
Add: Charge for the year	26	12	27	9
Additions arising from dissolution of subsidiary	–	–	–	19
Additions through the CNA/XJA Acquisitions	44	–	44	–
Less: Write-off during the year	45	2	46	–
Balance as at 31 December,	95	70	82	57

Except for the balances disclosed in Note 46, there was no amount due from shareholders who hold 5% or more voting right of the Company included in the balance of trade receivables.

During the year, the Group and the Company had no individually significant recovery of doubtful debts that had been fully or substantially provided for in prior years.

At 31 December, 2004, the Group and the Company did not have any individually significant trade receivables aged over three years.

At 31 December, 2004, the total amounts of the Group's and the Company's largest 5 trade receivables were as follows:

	The Group		The Company	
	2004	2003	2004	2003
Amounts (RMB million)	408	543	345	459
% of total trade receivables	24%	56%	25%	62%

## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

## 8 OTHER RECEIVABLES

	The Group		The Company	
	2004 RMB million	2003 RMB million	2004 RMB million	2003 RMB million
Due from subsidiaries	–	–	917	527
Due from related companies	62	17	62	17
Others	743	330	490	240
	805	347	1,469	784
Less: Provision for bad and doubtful debts	74	30	74	30
	731	317	1,395	754

Provision for bad and doubtful debts is analysed as follows:

	The Group and the Company	
	2004 RMB million	2003 RMB million
Balance as at 1 January,	30	30
Add: Charge for the year	2	–
Additions through the CNA/XJA Acquisitions	59	–
Less: Write-off during the year	17	–
Balance as at 31 December,	74	30

Ageing analysis of other receivables is as follows:

## The Group

	2004				2003			
	Amount RMB million	% of total other receivables %	Bad debt provision RMB million	% of bad debt provision %	Amount RMB million	% of total other receivables %	Bad debt provision RMB million	% of bad debt provision %
Within 1 year	625	77.6%	2	0.3%	286	82.3%	–	0.0%
Over 1 year but within 2 years	60	7.5%	–	0.0%	21	5.9%	–	0.0%
Over 2 years but within 3 years	35	4.3%	–	0.0%	7	2.1%	–	0.0%
Over 3 years	85	10.6%	72	84.7%	33	9.7%	30	89.6%
Total	805	100.0%	74	9.2%	347	100.0%	30	8.6%



## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 8 OTHER RECEIVABLES (cont'd)

#### The Company

	2004				2003			
	Amount RMB million	% of total other receivables %	Bad debt provision RMB million	% of bad debt provision %	Amount RMB million	% of total other receivables %	Bad debt provision RMB million	% of bad debt provision %
Within 1 year	1,259	85.7%	2	0.2%	740	94.3%	-	0.0%
Over 1 year but within 2 years	91	6.2%	-	0.0%	8	1.0%	-	0.0%
Over 2 years but within 3 years	35	2.4%	-	0.0%	5	0.7%	-	0.0%
Over 3 years	84	5.7%	72	85.7%	31	4.0%	30	96.3%
<b>Total</b>	<b>1,469</b>	<b>100.0%</b>	<b>74</b>	<b>5.0%</b>	<b>784</b>	<b>100.0%</b>	<b>30</b>	<b>3.8%</b>

Except for the balances disclosed in Note 46, there was no amount due from shareholders who hold 5% or more voting right of the Company included in the balance of other receivables.

During the year, the Group and the Company had no individually significant recovery of doubtful debts that had been fully or substantially provided for in prior years.

At 31 December, 2004, the Group and the Company had no individually significant other receivables that aged over three years.

At 31 December, 2004, the total amounts of the Group's and the Company's largest 5 other receivables were as follows:

	The Group		The Company	
	2004	2003	2004	2003
Amounts (RMB million)	194	111	976	459
% of total other receivables	24%	32%	66%	58%

### 9 ADVANCE PAYMENTS

All advance payments are aged within one year.

There was no amount due from shareholders who hold 5% or more voting right of the Company included in the balance of advance payments.

## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

## 10 INVENTORIES

	The Group		The Company	
	2004 RMB million	2003 RMB million	2004 RMB million	2003 RMB million
At cost:				
Expendable spare parts	1,267	573	904	183
Consumables	61	35	58	16
Aviation on-board supplies	27	20	24	10
Others	43	4	13	2
<b>Total</b>	<b>1,398</b>	<b>632</b>	<b>999</b>	<b>211</b>

At 31 December, 2004, no provision for impairment in value was necessary for the inventories of the Group and the Company.

All of the above inventories were obtained by way of purchases.

The Group's and the Company's cost of inventories charged to costs and expenses in the income statement were as follows:

	2004 RMB million	2003 RMB million
The Group	448	501
The Company	275	293

## 11 PREPAID EXPENSES

	Notes	The Group		The Company	
		2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Operating lease rentals	(a)	167	127	105	75
Ticket sales commissions	(b)	24	21	23	19
Catering and consumables	(c)	79	33	–	–
Insurance premiums	(d)	40	11	36	11
Others		36	11	35	9
<b>Total</b>		<b>346</b>	<b>203</b>	<b>199</b>	<b>114</b>



## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 11 PREPAID EXPENSES (cont'd)

Notes:

- (a) Pursuant to aircraft operating lease agreements, the Group is required to prepay one to six months' rentals to lessors. The prepaid rentals are then amortised over the relevant lease periods. The balance at the year end represents the unamortised balance of the prepaid rentals.
- (b) The Group pays sales commissions to sales agents for tickets sales. The sales commissions are initially recorded as prepaid expenses and charged to the income statement upon the provision of the related transportation services.
- (c) A jointly controlled entity of the Group is principally engaged in the provision of engine repairs and maintenance services. Consumables consumed prior to the completion of the related engine repairs and maintenance are recorded as prepaid expenses and charged to income statement upon the completion of the related engine repairs and maintenance services.
- (d) The Group prepays the insurance premiums to an insurance company. The prepaid insurance premiums are then amortized over the relevant period. The balance at the year end represents the unamortised balance of the prepaid insurance premiums.

### 12 LONG-TERM EQUITY INVESTMENTS

#### The Group

	Investments in associated companies RMB million	Other investments in stocks RMB million	Other equity investments RMB million	Total RMB million
Balance as at 1 January, 2004	422	57	143	622
Add: Additions	9	6	2	17
Additions through the CNA/XJA				
Acquisitions	–	–	69	69
Adjustment under the equity accounting method	49	–	–	49
Less: Dividends received	12	–	–	12
Disposals	1	1	2	4
<b>Balance as at 31 December, 2004</b>	<b>467</b>	<b>62</b>	<b>212</b>	<b>741</b>

## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 12 LONG-TERM EQUITY INVESTMENTS (cont'd)

#### The Company

	Investments in subsidiaries	Investments in associated companies	Investments in jointly controlled entities	Other investments in stocks	Other equity investments	Total
	RMB million	RMB million	RMB million	RMB million	RMB million	RMB million
Balance as at 1 January, 2004	2,601	311	644	1	101	3,658
Add: Additions	230	9	9	-	-	248
Additions through the CNA/XJA Acquisitions	155	-	-	-	69	224
Adjustment under the equity accounting method	215	50	(43)	-	-	222
Amortisation of equity investment differences	2	-	-	-	-	2
Less: Dividends received	34	12	-	-	-	46
Disposals	79	1	-	1	-	81
<b>Balance as at 1 December, 2004</b>	<b>3,090</b>	<b>357</b>	<b>610</b>	<b>-</b>	<b>170</b>	<b>4,227</b>

At 31 December, 2004, no provision for impairment losses for the long-term equity investments of the Group and the Company was necessary.

In connection with the Group's overseas listing, the assets of the Group as at 31 December, 1996 were revalued. As a result of this revaluation, the Company's subsidiaries had a net revaluation deficit amounting to RMB30,284,000. The Company made corresponding adjustments amounting to RMB20,498,000 to investments in these subsidiaries. These adjustments were recorded as equity investment differences and amortised on a straight-line basis over 10 years, which represented the estimated remaining useful lives of the revalued assets of the subsidiaries. The equity investment differences are analysed as follows:

	Equity investment difference RMB million
<b>Original amount</b>	<b>20</b>
<b>Accumulated amortisation:</b>	
At 1 January, 2004	14
Amortisation for the year	2
<b>At 31 December, 2004</b>	<b>16</b>
<b>Unamortised balance:</b>	
<b>At 31 December, 2004</b>	<b>4</b>
At 31 December, 2003	6

Details of the Group's associated companies, jointly controlled entities and the Company's subsidiaries are set out in Notes 50.



## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 12 LONG-TERM EQUITY INVESTMENTS (cont'd)

Details of the Group's and the Company's equity investments accounted for under the equity method are analysed as follows:

#### The Group

##### *Investments in associated companies:*

	SA Finance RMB million	Sichuan Airlines Corporation Limited (Note) RMB million	Others RMB million	Total RMB million
Attributable equity interest:				
Direct	32%	39%	–	–
Indirect	15.42%	–	17.1%	–
Initial investment costs (as at 1 January, 2004)	246	137	79	462
Balance as at 1 January, 2004	245	164	13	422
Add: Additions	–	–	9	9
Adjustment under the equity accounting method	(9)	55	3	49
Less: Dividends received	–	10	2	12
Disposals	–	–	1	1
<b>Balance as at 31 December, 2004</b>	<b>236</b>	<b>209</b>	<b>22</b>	<b>467</b>

Note: The principal accounting policies of Sichuan Airlines are different from the Group's. The major difference is on the accounting policies of repairs and maintenance expenses. Repairs and maintenance expenses of rotables are expensed as and when incurred in the Group's financial statements whereas such expenses are capitalised and amortised over 6 years in Sichuan Airlines' financial statements. Repairs and maintenance expense of aircraft and engines are expensed as and when incurred in the Group's financial statements whereas such expenses are capitalised and amortised over 1-10 years in Sichuan Airlines' financial statements.

## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

**12 LONG-TERM EQUITY INVESTMENTS** (cont'd)**The Company***Investments in subsidiaries*

	Southern Airlines (Group)						Total
	Xiamen Airlines Company Limited	Shantou Airlines Company Limited	Guangxi Airlines Company Limited	Zhuhai Airlines Company Limited	Guizhou Airlines Company Limited	Other subsidiaries	
	RMB million	RMB million	RMB million	RMB million	RMB million	RMB million	RMB million
Attributable equity interest:							
Direct	60%	60%	60%	60%	60%	-	
Period of operations	-	16 years	-	20 years	-	-	
Initial investment costs (as at 1 January, 2004)	353	168	103	150	48	269	1,091
Balance as at 1 January, 2004	1,822	167	140	85	44	343	2,601
Add: Additions	-	-	-	-	-	230	230
Additions through the CNA/XJA Acquisitions	-	-	-	-	-	155	155
Adjustment under the equity accounting method	158	3	37	(20)	32	5	215
Amortisation of equity investment differences	4	-	(2)	3	-	(3)	2
Less: Dividends received	-	8	14	-	-	12	34
Disposals	-	-	-	-	-	79	79
<b>Balance as at 31 December, 2004</b>	<b>1,984</b>	<b>162</b>	<b>161</b>	<b>68</b>	<b>76</b>	<b>639</b>	<b>3,090</b>





Notes to the Financial Statements (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

**12 LONG-TERM EQUITY INVESTMENTS** (cont'd)

**The Company** (cont'd)

*Investments in associated companies*

	<b>SA Finance</b> RMB million	<b>Sichuan Airlines Corporation Limited (Note)</b> RMB million	<b>Others</b> RMB million	<b>Total</b> RMB million
Attributable equity interest:				
Direct	32%	39%		
Initial investment costs (as at 1 January, 2004)	127	137	78	342
Balance as at 1 January, 2004	134	164	13	311
Add: Additions	-	-	9	9
Adjustment under the equity accounting method	(8)	55	3	50
Less: Dividends received	-	10	2	12
Disposals	-	-	1	1
<b>Balance as at 31 December, 2004</b>	<b>126</b>	<b>209</b>	<b>22</b>	<b>357</b>

Note: The principal accounting policies of Sichuan Airlines are different from the Company's. The major difference is on the accounting policies of repairs and maintenance expenses. Repairs and maintenance expenses of rotables are expensed as and when incurred in the Company's financial statements whereas such expenses are capitalised and amortised over 6 years in Sichuan Airlines' financial statements. Repairs and maintenance expense of aircraft and engines are expensed as and when incurred in the Company's financial statements whereas such expenses are capitalised and amortised over 1-10 years in Sichuan Airlines' financial statements.

## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 12 LONG-TERM EQUITY INVESTMENTS (cont'd)

#### The Company (cont'd)

##### Investments in jointly controlled entities

	China Postal Airlines Limited RMB million	Guangzhou Aircraft Maintenance Engineering Company Limited RMB million	MTU Maintenance Zhuhai Co. Ltd. RMB million	Beijing Southern Ground Services Company Limited RMB million	Total RMB million
Attributable equity interest:					
Direct	49%	50%	50%	50%	
Period of operations	15 years	40 years	30 years	16 years	
Initial investment costs (as at 1 January, 2004)	150	87	261	–	498
Balance as at 1 January, 2004	129	333	182	–	644
Add: Additions	–	–	–	9	9
Adjustment under the equity accounting method	(38)	34	(35)	(4)	(43)
<b>Balance as at 31 December, 2004</b>	<b>91</b>	<b>367</b>	<b>147</b>	<b>5</b>	<b>610</b>

The Group's and the Company's investments in the above companies are not subject to any restrictions on realisation of the investments and remittance of the investment returns.

At 31 December, 2004, the Group's and the Company's other investments in stocks are analysed as follows:

Name of investees	Type of investment	Number of shares held	Percentage of equity interest held	Initial investment cost RMB million	2004 RMB million	2003 RMB million
<b>The Company:</b>						
Hainan Meilan International Airport Co., Ltd.	Ordinary shares	925,000	0.37%	–	–	1
<b>Subsidiaries:</b>						
Travelsky Technology Limited	Legal person shares	21,924,500	2.5%	33	33	33
China Pacific Insurance Co. Ltd.	Ordinary shares	10,000,000	0.5%	13	13	13
Bank of Communications	Ordinary shares	7,480,000	0.008%	11	11	10
Others					5	–
					<b>62</b>	<b>57</b>



Notes to the Financial Statements (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

**12 LONG-TERM EQUITY INVESTMENTS** (cont'd)

At 31 December, 2004, the Group's and the Company's other equity investments are analysed as follows:

Name of investees	Investment period (Years)	Initial investment cost RMB million	Percentage of equity interest held	As at 31 December, 2004 RMB million	As at 31 December, 2003 RMB million
<b>The Company:</b>					
Haikou Meilan Airport International Co., Ltd.	-	100	7.4%	100	100
CITIC Offshore Helicopter Co., Ltd	-	69	6%	69	-
Hunan Southern Airlines Travel Service Co., Ltd (Note)	10 years	1	54%	1	1
				<b>170</b>	<b>101</b>
<b>Subsidiaries:</b>					
Xiamen Aviation Industry Co. Ltd.	-	20	10%	20	20
CAAC Express Ltd	-	8	4.29%	8	8
Xiamen Soccer Club	-	3	4.94%	3	3
China Aircraft Services Ltd.	-	2	1%	2	2
Guangzhou International Logistics Company Limited (Note)	10 years	2	51%	2	-
Zhuhai Air-Express Co., Ltd. (Note)	-	1	30%	1	1
Guilin Guangsheng Development Co., Ltd (Note)	10 years	1	30%	1	1
Guangzhou Baiyun International Express Customs Supervision Co., Ltd. (Note)	-	2	55%	-	2
Other	-	-	-	5	5
				<b>42</b>	<b>42</b>
<b>Total</b>				<b>212</b>	<b>143</b>

Note: The impact of these companies on the Group's results for the year was not material. Accordingly, they have been accounted for under cost method (Note 50). Whilst the Group holds more than 50% equity interest in certain of these companies, their financial statements are not consolidated in the Group's financial statements because their aggregate assets, liabilities and results of operations had no significant effect to the Group.

At 31 December, 2004, the proportion of the total amount of the Group's and the Company's long-term equity investments to the net assets was 6% and 36% respectively (2003: 5% and 32% respectively).

## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

## 13 FIXED ASSETS

## The Group

	Land use rights and buildings RMB million	Aircraft		Other flight equipment including rotable spares RMB million	Machinery, equipment and motor vehicles RMB million	Total RMB million
		Owned	Held under finance leases RMB million			
<b>Cost or valuation:</b>						
At 1 January, 2004	3,920	17,222	10,463	7,017	2,276	40,898
Reclassification on exercise of purchase options	-	550	(550)	-	-	-
Additions through the CNA/XJA						
Acquisitions	907	5,206	4,492	1,753	490	12,848
Additions	346	4,156	-	629	191	5,322
Transferred from construction in progress	2,730	-	-	-	266	2,996
Reclassification (Note 18)	(408)	-	-	-	-	(408)
Disposals	(28)	-	-	(76)	(226)	(330)
<b>At 31 December, 2004</b>	<b>7,467</b>	<b>27,134</b>	<b>14,405</b>	<b>9,323</b>	<b>2,997</b>	<b>61,326</b>
<b>Accumulated depreciation:</b>						
At 1 January, 2004	697	3,192	2,605	3,691	1,318	11,503
Reclassification on exercise of purchase options	-	183	(183)	-	-	-
Charge for the year	166	955	472	656	246	2,495
Reclassification (Note 18)	(44)	-	-	-	-	(44)
Written back on disposal	(17)	-	-	(66)	(165)	(248)
<b>At 31 December, 2004</b>	<b>802</b>	<b>4,330</b>	<b>2,894</b>	<b>4,281</b>	<b>1,399</b>	<b>13,706</b>
<b>Net book value:</b>						
<b>At 31 December, 2004</b>	<b>6,665</b>	<b>22,804</b>	<b>11,511</b>	<b>5,042</b>	<b>1,598</b>	<b>47,620</b>
At 31 December, 2003	3,223	14,030	7,858	3,326	958	29,395



Notes to the Financial Statements (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

13 FIXED ASSETS (cont'd)

The Company

	Land use rights and buildings RMB million	Aircraft		Other flight equipment including rotable spares RMB million	Machinery, equipment and motor vehicles RMB million	Total RMB million
		Owned	Held under finance leases RMB million			
<b>Cost or valuation:</b>						
At 1 January, 2004	1,879	12,868	10,463	5,396	1,189	31,795
Reclassification on exercise of purchase options	-	550	(550)	-	-	-
Additions through the CNA/XJA						
Acquisitions	722	5,206	4,492	1,745	441	12,606
Additions	77	3,509	-	327	51	3,964
Transferred from construction in progress	1,663	-	-	-	235	1,898
Reclassification (Note 18)	(301)	-	-	-	-	(301)
Disposals	(23)	-	-	-	(40)	(63)
<b>At 31 December, 2004</b>	<b>4,017</b>	<b>22,133</b>	<b>14,405</b>	<b>7,468</b>	<b>1,876</b>	<b>49,899</b>
<b>Accumulated depreciation:</b>						
At 1 January, 2004	346	2,231	2,605	3,073	717	8,972
Reclassification on exercise of purchase options	-	183	(183)	-	-	-
Charge for the year	120	744	472	418	126	1,880
Reclassification (Note 18)	(32)	-	-	-	-	(32)
Written back on disposal	(10)	-	-	-	(35)	(45)
<b>At 31 December, 2004</b>	<b>424</b>	<b>3,158</b>	<b>2,894</b>	<b>3,491</b>	<b>808</b>	<b>10,775</b>
<b>Net book value:</b>						
<b>At 31 December, 2004</b>	<b>3,593</b>	<b>18,975</b>	<b>11,511</b>	<b>3,977</b>	<b>1,068</b>	<b>39,124</b>
At 31 December, 2003	1,533	10,637	7,858	2,323	472	22,823

At 31 December, 2004, no provision for the impairment losses for fixed assets of the Group and Company was necessary.

At 31 December, 2004, the net book values of the fully depreciated fixed assets of the Group and the Company in use were RMB54 million and RMB38 million respectively (2003: RMB60 million and RMB43 million respectively).

The period of land use rights granted ranged from 30 to 70 years. As at 31 December, 2004, the remaining unamortised period ranged from 16 years to 64 years.

## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 13 FIXED ASSETS (cont'd)

At 31 December, 2004, certain aircraft and other flight equipment of the Group and the Company were mortgaged under certain bank loans and finance lease agreements (see Notes 29 and 30). The net book value of these fixed assets is analysed as follows:

	The Group		The Company	
	2004 RMB million	2003 RMB million	2004 RMB million	2003 RMB million
Aircraft				
Mortgaged under bank loans	11,927	6,719	10,179	4,939
Mortgaged under finance leases	11,511	7,857	11,511	7,857
Sub-total	23,438	14,576	21,690	12,796
Other flight equipment				
Mortgaged under bank loans	7	26	–	–
Total	23,445	14,602	21,690	12,796

At 31 December, 2004, the net book value of the Company's fixed assets leased out under operating leases are analysed as follows:

	The Company	
	2004 RMB million	2003 RMB million
Land use rights and buildings	142	147
Other flight equipment	131	178
	273	325

The Company entered into two separate arrangements (the "Arrangements") with certain independent third parties during each of 2002 and 2003, under each of the Arrangements, the Company sold an aircraft and then immediately leased back the aircraft. As agreed, the lease payment obligations, with pre-determined net present values, were to be satisfied solely out of the sale proceeds and such amounts have been placed irrevocably by the Company in form of deposits and debt securities in favour of the lessors. The Company has an option to purchase the aircraft at a pre-determined date and the agreed purchase price is to be satisfied by the balance of the deposits and debt securities outstanding at that date. In the event that the lease agreements are early terminated by the Company, the Company is liable to pay a pre-determined penalty to the lessors. As long as the Company complies with the lease agreements, the Company is entitled to the continued possession and operation of the aircraft. Since the Company retains substantially all the risks and rewards incident to ownership of the aircraft and enjoys substantially the same rights to their use as before the Arrangements, no adjustment has been made to the fixed assets. As at 31 December, 2004, the net present value of the lease commitments and the corresponding defeased deposits and debt securities amounted to RMB2,462 million (2003: RMB 2,409 million). As a result of the Arrangements, the Company received net cash benefits which were recognised as income in the relevant period.



## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 14 CONSTRUCTION MATERIALS

The Group's and the Company's construction materials mainly represented the materials to be used for construction projects

### 15 CONSTRUCTION IN PROGRESS

Project	Budget	Balance	Additions			Balance	Percentage of progress	Source of funding
		as at 1 January,	through the CNA/XJA	through the	Transferred	as at 31 December, 2004		
	RMB million	RMB million	Addition	Acquisitions	to fixed assets	RMB million		
			RMB million	RMB million	RMB million	RMB million		
<b>The Company:</b>								
Guangzhou new airport base	3,450	1,378	400	-	(1,778)	-		
Hubei catering building	31	28	3	-	(31)	-		
Zhengzhou ticket selling office	49	22	-	-	(22)	-		
Material and engineering system	39	21	1	-	-	22	56%	Self-financing
Guangzhou new airport supporting area	89	-	55	-	-	55	62%	Self-financing
Henan office building	19	14	5	-	(19)	-		
B777 engine upgrading project	95	12	6	-	-	18	19%	Self-financing
Shenzhen cargo centre	40	-	22	-	-	22	55%	Self-financing
Pilot quarters	-	8	2	-	(10)	-		
Integrated office tower	18	12	3	-	(15)	-		
Motor vehicle warehouse	24	12	8	-	(20)	-		
Others	120	36	47	22	(3)	102		Self-financing
<b>Company total</b>	<b>3,974</b>	<b>1,543</b>	<b>552</b>	<b>22</b>	<b>(1,898)</b>	<b>219</b>		
<b>Subsidiaries:</b>								
Guangzhou new cargo centre	1,275	182	975	-	(854)	303	91%	35% bank loans
Fuzhou Chang Le airport facilities	157	14	12	-	(6)	20	17%	Self-financing
Others	210	40	50	4	(26)	68		Self-financing
<b>Subsidiary total</b>	<b>1,642</b>	<b>236</b>	<b>1,037</b>	<b>4</b>	<b>(886)</b>	<b>391</b>		
<b>Jointly controlled entities:</b>								
Guangzhou new airport base	430	151	67	-	(205)	13	51%	Self-financing
Others	13	7	3	-	(7)	3		Self-financing
<b>Jointly controlled entity total</b>	<b>443</b>	<b>158</b>	<b>70</b>	<b>-</b>	<b>(212)</b>	<b>16</b>		
<b>Group total</b>	<b>6,059</b>	<b>1,937</b>	<b>1,659</b>	<b>26</b>	<b>(2,996)</b>	<b>626</b>		

At 31 December, 2004, the Group and the Company did not have any provision for the impairment of construction in progress.

## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 15 CONSTRUCTION IN PROGRESS (cont'd)

The Group's borrowing costs capitalised in the construction in progress for the year are as follows:

	2004 RMB million	2003 RMB million
Borrowing cost capitalised	23	83

The interest rates at which the Group's and the Company's borrowing costs were capitalised during the year ranged from 1.51% to 3.48% (2003: 1.62% to 5.46%) per annum.

### 16 LEASE AND EQUIPMENT DEPOSITS

	The Group				The Company			
	2004		2003		2004		2003	
	Original currency million	RMB million	Original currency million	RMB million	Original currency million	RMB million	Original currency million	RMB million
Advance payments for purchase of aircraft (US\$)	560	4,640	304	2,516	486	4,024	229	1,900
Rental deposits for aircraft under operating leases (US\$)	92	757	50	417	75	650	40	329
		5,397		2,933		4,674		2,229

Pursuant to aircraft purchase agreements, the Group is generally required to pay a deposit equal to approximately 30% of the purchase price of the aircraft to aircraft manufacturers six months prior to delivery.

Pursuant to aircraft operating lease agreements, the Group and the Company are generally required to pay lessors rental deposits equal to approximately three months' rentals.





Notes to the Financial Statements (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

**17 LONG-TERM DEFERRED EXPENDITURE**

	<b>The Group</b>	<b>The Company</b>
	RMB million	RMB million
<b>Cost:</b>		
At 1 January, 2004	65	36
Additions	17	2
Additions through the CNA/XJA Acquisitions	103	102
Write off	(21)	(20)
<b>At 31 December, 2004</b>	<b>164</b>	<b>120</b>
<b>Accumulated amortisation:</b>		
At 1 January, 2004	39	19
Amortisation for the year	15	12
Write off	(21)	(20)
<b>At 31 December, 2004</b>	<b>33</b>	<b>11</b>
<b>Carrying value:</b>		
<b>At 31 December, 2004</b>	<b>131</b>	<b>109</b>
At 31 December, 2003	26	17

Long-term deferred expenditure mainly comprises custom duties and other direct costs incurred in respect of the Group's and the Company's operating leased aircraft upon the inception of their respective leases. The balance is amortised on a straight-line basis over the lease period of the aircraft.

At 31 December, 2004, the remaining unamortised period ranged from 2 to 3 years.

## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 18 INTANGIBLE ASSETS

	The Group RMB million	The Company RMB million
<b>Cost:</b>		
Balance as at 1 January, 2004	–	–
Reclassification (Note 13)	408	301
Additions	102	26
Additions through the CNA/XJA Acquisitions	9	6
<b>Balance as at 31 December, 2004</b>	<b>519</b>	<b>333</b>
<b>Accumulated amortisation:</b>		
Balance as at 1 January, 2004	–	–
Reclassification (Note 13)	44	32
Charge for the year	8	5
<b>Balance as at 1 December, 2004</b>	<b>52</b>	<b>37</b>
<b>Carrying value:</b>		
<b>At 31 December, 2004</b>	<b>467</b>	<b>296</b>
At 31 December, 2003	–	–

During 2004, the Group reclassified land use rights not yet commenced developments or constructions from fixed assets to intangible assets pursuant to “Accounting Regulations for Business Enterprises”. In addition, the Group reclassified land use rights acquired before 1 January, 2001 from fixed assets to intangible assets pursuant to “Questions and Answers on Implementing Accounting Regulations for Business Enterprises and Related Accounting Standards” as set out in notice “Cai Kua 【2001】 No. 43”.

### 19 LONG-TERM RECEIVABLES

Long-term receivables represent insurance premiums deposited with a PRC insurance company. Pursuant to the relevant insurance agreement, the insurance premiums will be fully refunded to the Group upon the expiry of the agreement in 2007.



Notes to the Financial Statements (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

20 SHORT-TERM LOANS

The Group's and the Company's short term loans are analysed as follows:

	The Group				The Company			
	2004		2003		2004		2003	
	Original currency million	RMB million	Original currency million	RMB million	Original currency million	RMB million	Original currency million	RMB million
Unsecured loans								
US Dollars	682	5,650	709	5,867	678	5,612	659	5,458
Hong Kong Dollars	2,678	2,842	194	207	2,678	2,842	-	-
Renminbi		1,270		120		766		120
Sub-total		9,762		6,194		9,220		5,578
Guaranteed loans								
Renminbi		411		235		-		-
Sub-total		411		235		-		-
Total		10,173		6,429		9,220		5,578

The guaranteed loans were guaranteed by the following parties:

	The Group		The Company	
	2004 RMB million	2003 RMB million	2004 RMB million	2003 RMB million
CSAHC	411	151	-	-
Guangzhou Baiyun International Airport Company Limited	-	63	-	-
Shenzhen Yingshun Investment Development Company Limited	-	21	-	-
	411	235	-	-

At 31 December, 2004, the Group's and the Company's weighted average interest rates on short-term borrowings were 1.6% and 1.56% per annum respectively (2003: 1.76% and 1.65% per annum respectively).

At 31 December, 2004, the Group and the Company had no overdue short-term loans (2003: Nil).

There were no short-term loans payable to shareholders who hold 5% or more of the voting rights of the Company.

## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 21 BILLS PAYABLE

#### The Group

	2004		2003	
	RMB million	%	RMB million	%
Bank accepted bills	72	52.6%	2	0.4%
Commercial bills	65	47.4%	446	99.6%
	<b>137</b>	<b>100.0%</b>	448	100.0%

#### The Company

	2004		2003	
	RMB million	%	RMB million	%
Bank accepted bills	71	52.2%	2	0.4%
Commercial bills	65	47.8%	436	99.6%
	<b>136</b>	<b>100.0%</b>	438	100.0%

All bills payable are due within one year.

There were no bills payable to shareholders who hold 5% or more of the voting rights of the Company.

### 22 TRADE PAYABLES

The ageing analysis of trade payables is as follows:

	The Group		The Company	
	2004 RMB million	2003 RMB million	2004 RMB million	2003 RMB million
Within 3 months	1,871	1,018	1,715	909
Over 3 months but within 6 months	349	278	301	231
Over 6 months	380	371	315	308
	<b>2,600</b>	1,667	<b>2,331</b>	1,448

Except for the balances disclosed in Note 46, there were no trade payables to shareholders who hold 5% or more of the voting rights of the Company in the balance of trade payables.

At 31 December, 2004, the Group and the Company had no individual significant trade payables aged over three years.

Notes to the Financial Statements (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)**23 SALES IN ADVANCE OF CARRIAGE**

Sales in advance of carriage represent the proceeds from sales of the Group's and the Company's air tickets in advance of carriage. The sales in advance of carriage are aged within one year.

There were no payable to shareholders who hold 5% or more of the voting rights of the Company in the balance of sales in advance of carriage.

**24 CAAC INFRASTRUCTURE DEVELOPMENT FUND PAYABLE**

	The Group		The Company	
	2004 RMB million	2003 RMB million	2004 RMB million	2003 RMB million
At 1 January, 2004	354	281	293	201
Add: Amount payable for the year	433	251	303	168
Additions through the CNA/XJA Acquisitions	37	–	37	–
Less: Payments during the year	662	178	525	76
At 31 December, 2004	162	354	108	293

**25 OTHER CREDITORS**

Other creditors represent payables for education surcharge.

**26 OTHER PAYABLES**

Except for the balances disclosed in Note 46, there were no payables to shareholders who hold 5% or more of the voting rights of the Company in the balance of other payables.

At 31 December, 2004, the Group and the Company had no individual significant other payables aged over three years.

## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

## 27 ACCRUED EXPENSES

	Notes	The Group		The Company		Reason for accrual
		2004 RMB million	2003 RMB million	2004 RMB million	2003 RMB million	
Custom duties and value-added tax	(a)	71	337	45	103	Accrued but not paid
Landing and take-off fees	(b)	1,383	826	1,100	585	Accrued but not paid
Aircraft and engine repair charges	(b)	901	242	983	253	Accrued but not paid
Staff housing allocations and lump sum housing allowances	(c)	145	215	145	215	Accrued but not paid
Interest expense	(d)	249	158	229	138	Accrued but not paid
Jet fuel expenses	(b)	377	255	226	118	Accrued but not paid
Sales commissions and bonuses		14	62	14	62	Accrued but not paid
Air catering expenses	(b)	98	114	118	134	Accrued but not paid
Provision for major overhauls – current portion (Note 31)		75	11	62	–	Accrued but not paid
Seat reservation charges		144	55	100	42	Accrued but not paid
Aircraft insurance premiums		13	–	3	–	Accrued but not paid
Operating lease rentals		25	18	15	15	Accrued but not paid
Other expenses		234	94	151	18	Accrued but not paid
<b>Total</b>		<b>3,729</b>	<b>2,387</b>	<b>3,191</b>	<b>1,683</b>	

Notes:

**(a) Custom duties and value-added tax**

Custom duties and value-added tax mainly represent custom duties and value-added tax payable by the Group in connection with purchases of aircraft. These custom duties and value-added tax payable have been capitalised as part of the aircraft's costs. The Group is required to pay the customs duties and value-added tax by instalments.

**(b) Landing and take-off fees, aircraft and engine repair expenses, jet fuel expenses and air catering expenses**

The transaction volumes and amounts involved for landing and take-off fees, aircraft and engine repair expenses, jet fuel expenses and air catering expenses are significant. Their settlements generally take two to three months. Therefore, such expenses were accrued in the year to which they related in order to match with revenue.

**(c) Staff housing allocations and lump sum housing allowances**

Pursuant to Cai Kuai Zi [2001] No. 5 issued by the MOF, staff housing allocation charges and lump sum housing allowances payable to employees who joined the Company before 1998 but not yet allocated with staff housing were recorded as accrued expenses. These expenses were debited against retained earnings at the beginning of 2001.



Notes to the Financial Statements (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

**27 ACCRUED EXPENSES** (cont'd)

Notes: (cont'd)

(d) **Interest expense**

Interest expense accrual was mainly from finance lease obligations and loans relating to the purchases of aircraft. The Group is generally required to repay the principal and interest once every three or six months. Therefore, interest expense was accrued in the year to which this is related.

**28 LONG-TERM LIABILITIES DUE WITHIN ONE YEAR**

	The Group				The Company			
	2004		2003		2004		2003	
	Original currency million	RMB million	Original currency million	RMB million	Original currency million	RMB million	Original currency million	RMB million
Long-term loans due within one year (Note 29)								
Guaranteed (RMB)		1		2		-		-
Unsecured (RMB)		16		64		-		-
Unsecured (US\$)	10	82	-	-	10	82	-	-
Mortgaged and guaranteed (US\$)	60	496	74	610	31	254	46	381
Mortgaged (US\$)	119	989	2	12	94	780	-	-
Mortgaged (RMB)		26		-		26		-
Sub-total		1,610		688		1,142		381
Obligations under finance leases due within one year (Note 30)								
Mortgaged and guaranteed								
- US Dollars	246	2,032	135	1,120	246	2,032	135	1,120
- Japanese Yen	615	49	2,298	178	615	49	2,298	178
Sub-total		2,081		1,298		2,081		1,298
Total		3,691		1,986		3,223		1,679

## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

**29 LONG-TERM LOANS****The Group**

Interest rate (at 31 December, 2004)	2004		2003	
	Original currency million	RMB million	Original currency million	RMB million
<b>Renminbi loans:</b>				
Fixed interest rates ranging from 4.80% to 6.03% per annum, with maturities through 2009.		1,687		77
Non-interest bearing loan from a municipal government authority, repayable in 2005.		3		3
Floating interest rates ranging from 4.94% to 5.76% per annum, with maturities through 2014.		1,217		76
<b>US dollar loans:</b>				
Floating interest rates ranging from 3 months LIBOR+0.65% to 0.9% per annum, with maturities through 2011.	212	1,753	–	–
Floating interest rates ranging from 6 months LIBOR+0.3% to 1.2% per annum, with maturities through 2014.	796	6,589	325	2,686
Fixed interest rates ranging from 2.18% to 8.35% per annum, with maturities through 2011.	323	2,676	317	2,626
<b>HK dollar loans:</b>				
Floating interest rates ranging from 3 months HIBOR+1.32% to 2.05% per annum, with maturities through 2005.	9	9	–	–
		13,934		5,468
Less: Current portion of long-term loans (Note 28)		(1,610)		(688)
		12,324		4,780





Notes to the Financial Statements (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

29 LONG-TERM LOANS (cont'd)

The Company

Interest rate (at 31 December, 2004)	2004		2003	
	Original currency million	RMB million	Original currency million	RMB million
<b>Renminbi loans:</b>				
Fixed interest rates ranging from 4.80% to 6.03% per annum, with maturities through 2009.		135		–
Floating interest rates ranging from 4.94% to 5.76% per annum, with maturities through 2014.		1,217		–
<b>US dollar loans:</b>				
Floating interest rates ranging from 3 months LIBOR+0.65% to 0.9% per annum, with maturities through 2011.	172	1,426	–	–
Floating interest rates ranging from 6 months LIBOR+0.3% to 1.2% per annum, with maturities through 2014.	795	6,578	302	2,505
Fixed interest rates ranging from 2.18% to 8.35% per annum, with maturities through 2011.	281	2,326	187	1,546
		11,682		4,051
Less: Current portion of long-term loans (Note 28)		(1,142)		(381)
		10,540		3,670

The long-term loans by borrowing terms are analysed as follows:

	The Group		The Company	
	2004 RMB million	2003 RMB million	2004 RMB million	2003 RMB million
Unsecured loans	4,538	85	4,459	–
Guaranteed loans	2,424	430	1,812	229
Mortgaged loans	4,800	2,388	4,240	2,324
Mortgaged and guaranteed loans	2,172	2,565	1,171	1,498
	13,934	5,468	11,682	4,051

## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 29 LONG-TERM LOANS (cont'd)

The guaranteed loans were guaranteed by the following parties:

	The Group		The Company	
	2004 RMB million	2003 RMB million	2004 RMB million	2003 RMB million
CSAHC	2,415	420	1,812	229
SA Finance	9	10	–	–
	<b>2,424</b>	<b>430</b>	<b>1,812</b>	<b>229</b>

The mortgaged and guaranteed loans were secured by mortgages over certain of the Group's and the Company's aircraft (Note 13), and were guaranteed by the following parties:

	The Group		The Company	
	2004 RMB million	2003 RMB million	2004 RMB million	2003 RMB million
Export-Import Bank of the United States	1,732	2,208	969	1,236
Bank of China	291	357	53	262
The Industrial and Commercial Bank of China	149	–	149	–
	<b>2,172</b>	<b>2,565</b>	<b>1,171</b>	<b>1,498</b>

The mortgaged loans were secured by mortgages over certain of the Group's and the Company's aircraft and other flight equipment (Note 13).

The maturity analysis of the long-term loans is as follows:

	The Group		The Company	
	2004 RMB million	2003 RMB million	2004 RMB million	2003 RMB million
Balance due:				
Within one year	1,610	688	1,142	381
In the second year	1,698	683	1,476	402
In the third year	4,436	488	3,817	257
After the third year	6,190	3,609	5,247	3,011
	<b>13,934</b>	<b>5,468</b>	<b>11,682</b>	<b>4,051</b>

There were no payables to shareholders who hold 5% or more of the voting rights of the Company in the balance of long-term loans.



Notes to the Financial Statements (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

**30 OBLIGATIONS UNDER FINANCE LEASES**

**The Group and the Company**

	2004 RMB million	2003 RMB million
At 1 January,	6,841	8,198
Add: Additions through the CNA/XJA Acquisitions	6,001	–
Effect due to fluctuations of foreign exchange rates	49	198
Less: Payments during the year	1,272	1,555
At 31 December,	11,619	6,841
Less: Balance due within one year (Note 28)	2,081	1,298
	<b>9,538</b>	<b>5,543</b>

Obligations under finance leases represent the Group's commitments under finance lease agreements in respect of aircraft and related equipment expiring during from 2005 to 2013. At 31 December, 2004, the weighted average interest rate for obligations under finance leases was 5.50% per annum. Future payment obligations of the Group's and the Company's under finance leases are as follows:

	2004 RMB million	2003 RMB million
Balance due:		
Within one year	2,081	1,298
In the second year	2,829	1,066
In the third year	2,559	1,197
After the third year	4,150	3,280
	<b>11,619</b>	<b>6,841</b>

Under the terms of the leases, the Group has an option to purchase, at or near the end of the lease term, certain aircraft at fair market value and other aircraft at either fair market value or a percentage of the respective lessor's defined cost of the aircraft.

Certain of the Group's and the Company's aircraft and the related insurance policies were pledged to the lessors. The carrying amounts of these aircraft at 31 December, 2004 are disclosed in Note 13.

## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 30 OBLIGATIONS UNDER FINANCE LEASES (cont'd)

#### The Group and the Company (cont'd)

The Group's and the Company's obligations under finance leases were guaranteed by the following parties:

	2004 RMB million	2003 RMB million
Bank of China	7,134	2,577
The Industrial and Commercial Bank of China	4,485	4,264
	<b>11,619</b>	<b>6,841</b>

At 31 December, 2004, the Group's and the Company's obligations under finance leases analysed by original currencies were as follows:

	2004		2003	
	Original currency million	RMB million	Original currency million	RMB million
US Dollars	698	5,775	478	3,957
Japanese Yen	47,214	3,763	20,532	1,586
		<b>9,538</b>		<b>5,543</b>

Balance due within one year is disclosed in Note 28 to the financial statements.

There was no amount due to shareholders who hold 5% or more of the voting rights of the Company included in the balance of obligations under finance leases.

### 31 PROVISION FOR MAJOR OVERHAULS

	The Group RMB million	The Company RMB million
Balance at 1 January, 2004	200	131
Including current portion	11	-
Add: Provision for the year	89	47
Additions through the CNA/XJA Acquisitions	70	70
Balance at 31 December, 2004	359	248
Less: Current portions included in accrued expenses (Note 27)	75	62
	<b>284</b>	<b>186</b>



Notes to the Financial Statements (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

**32 DEFERRED CREDITS**

**The Group and the Company**

	Gain on sale and lease back transaction RMB million	Rebates on aircraft operating leases RMB million	Rebates on aircraft finance leases RMB million	Total RMB million
<b>Cost:</b>				
At 1 January, 2004	259	24	–	283
Additions through the CNA/XJA Acquisitions	–	36	21	57
<b>31 December, 2004</b>	<b>259</b>	<b>60</b>	<b>21</b>	<b>340</b>
<b>Accumulated amortisation:</b>				
At 1 January, 2004	48	18	–	66
Amortisation for the year	31	3	–	34
<b>At 31 December, 2004</b>	<b>79</b>	<b>21</b>	<b>–</b>	<b>100</b>
<b>Carrying value:</b>				
<b>At 31 December, 2004</b>	<b>180</b>	<b>39</b>	<b>21</b>	<b>240</b>
At 31 December, 2003	211	6	–	217

Pursuant to certain sale and leaseback arrangements, the Company sold certain aircraft to independent third parties and then entered into operating leases with such parties to lease back the aircraft for a period of eight to nine years. The gain on sale and leaseback arrangements, being the excess of the sale proceeds, which approximated the aircraft's fair value on the date of disposal, over the aircraft's net book value and related disposal costs, was deferred and amortised over the terms of the respective leases.

Pursuant to certain aircraft operating lease arrangements, the Group received cash rebates from the lessors. Such rebates were deferred and amortised over the terms of the respective leases.

Pursuant to certain aircraft finance lease arrangements with independent third parties, the Group received cash rebates from the lessors. Such rebates were deferred and amortised over the terms of the respective leases.

## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 33 DEFERRED TAXATION

The movements of net deferred tax liabilities/(assets) are as follows:

	The Group RMB million	The Company RMB million
Balance at 1 January, 2004	392	63
Less: Reduction for the year (Note 45)	(110)	(118)
<b>Balance at 31 December, 2004</b>	<b>282</b>	<b>(55)</b>

The deferred tax liabilities/(assets) were made up of the taxation effects of:

	Note	The Group		The Company	
		2004 RMB million	2003 RMB million	2004 RMB million	2003 RMB million
Deferred tax assets:					
Tax losses	(a)	39	223	39	223
Repairs and maintenance accruals	(b)	129	88	125	93
Rotables repair charges capitalised	(c)	254	261	195	199
Accrued expenses	(d)	143	19	143	19
Gains on sale and leaseback transactions	(e)	27	32	27	32
Other		18	8	22	11
<b>Total deferred tax assets</b>		<b>610</b>	631	<b>551</b>	577
Deferred tax liabilities:					
Repairs and maintenance accruals	(b)	74	80	-	-
Depreciation of fixed assets	(f)	757	873	459	616
Other		61	70	37	24
<b>Total deferred tax liabilities</b>		<b>892</b>	1,023	<b>496</b>	640
<b>Net deferred tax liabilities/(assets)</b>		<b>282</b>	392	<b>(55)</b>	63

Notes:

#### (a) Tax losses

Pursuant to the relevant tax regulations, taxable losses can be carried forward over a maximum period of five years to be offset against future taxable profits. The deferred tax is recognised based on the unutilised taxable losses and estimated future taxable profits.

#### (b) Repairs and maintenance accruals

Certain of the Group's and the Company's overhaul expenses were deductible on a cash payment basis for taxation purposes. According to the accounting policies adopted in these financial statements, overhaul expenses are expensed as and when incurred. The Group and the Company recognised the deferred tax for these timing differences.



## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 33 DEFERRED TAXATION (cont'd)

Notes: (cont'd)

#### (c) Rotables repair charges capitalised

Pursuant to the relevant tax regulations, repair charges for rotables are initially capitalised and amortised over five years for taxation purposes. According to the accounting policies adopted in these financial statements, repair charges for rotables are expensed as and when incurred. The Group and the Company recognised the deferred tax for these timing differences.

#### (d) Accrued expenses

Certain of the Group's and the Company's expenses are deductible on a cash payment basis for taxation purposes. In the preparation of these financial statements, these expenses are accounted for on an accrual basis. The Group and the Company recognised a deferred tax for these timing differences.

#### (e) Gains on sale and leaseback transactions

Pursuant to the relevant tax regulations, gains on sale and leaseback transactions are taxable in the period they arise. According to the accounting policies adopted in these financial statements, these gains are recorded as deferred credits and amortised over the terms of the leases. The Group and the Company recognised the deferred tax on these timing differences.

#### (f) Depreciation of fixed assets

Deferred tax was recognised for the timing difference arising from the difference between the aircraft depreciation rates for accounting purposes and the rates used for taxation purposes

### 34 SHARE CAPITAL

	2004 RMB million	2003 RMB million
(a) Registered capital:		
2,200,000,000 domestic shares of RMB1.00 each	2,200	2,200
1,174,178,000 H shares of RMB1.00 each	1,174	1,174
1,000,000,000 A shares of RMB1.00 each	1,000	1,000
	<b>4,374</b>	4,374
(b) Issued and paid up capital:		
2,200,000,000 domestic shares of RMB1.00 each	2,200	2,200
1,174,178,000 H shares of RMB1.00 each	1,174	1,174
1,000,000,000 A shares of RMB1.00 each	1,000	1,000
	<b>4,374</b>	4,374

Pursuant to an extraordinary general meeting of shareholders held on 21 May, 2002, a resolution was passed authorising the Company to issue not more than 1,000,000,000 A shares of par value of RMB1.00 each. Pursuant to an approval document (2003) No. 70 from the China Securities Regulatory Commission, the Company issued and listed its 1,000,000,000 A shares with a par value of RMB1.00 each on the Shanghai Stock Exchange in July 2003.

The receipt of above paid-in capital were verified by KPMG Huazhen which issued capital verification reports on 31 December, 1994, 10 September, 1997 and 17 July, 2003 respectively.

## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

**35 CAPITAL RESERVE****The Group and the Company**

	2004 RMB million	2003 RMB million
Balance at 1 January,	5,801	4,160
Share premium from A shares issue, net of issuance costs	–	1,641
Balance at 31 December,	5,801	5,801

**36 SURPLUS RESERVES**

	The Group		The Company	
	2004 RMB million	2003 RMB million	2004 RMB million	2003 RMB million
Statutory surplus reserve				
Balance at 1 January,	361	337	339	338
Add: Profit appropriations	41	24	10	1
Balance at 31 December,	402	361	349	339
Statutory public welfare fund				
Balance at 1 January,	173	172	172	171
Add: Profit appropriations	20	1	5	1
Balance at 31 December,	193	173	177	172
Discretionary surplus reserve				
Balance at 1 January,	77	77	77	77
Add: Profit appropriations	–	–	–	–
Balance at 31 December,	77	77	77	77
Total	672	611	603	588





## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 37 PROFIT APPROPRIATION

(a) Appropriations to surplus reserves

Pursuant to the Board of Directors' resolution on 25 April, 2005, the Company made appropriations to the following surplus reserves in respect of the year 2004:

(i)	Statutory surplus reserve	10%
(ii)	Statutory public welfare fund	5%

(b) On 25 April, 2005, the Board of Directors did not recommend the payment of a dividend to ordinary shareholders.

### 38 REVENUE FROM PRINCIPAL OPERATIONS

	The Group		The Company	
	2004 RMB million	2003 RMB million	2004 RMB million	2003 RMB million
Passenger	21,624	15,342	14,481	10,184
Cargo and mail	2,315	2,009	2,022	1,734
Others	255	–	232	–
	<b>24,194</b>	<b>17,351</b>	<b>16,735</b>	<b>11,918</b>

Revenue from principal operations represent revenues from airline businesses. The Group's segmental information is analysed in Note 47.

The total revenue from the Group's and the Company's top five customers and their percentage of the total revenue are analysed as follows:

	The Group		The Company	
	2004	2003	2004	2003
Amounts (RMB million)	209	260	173	223
% of total revenue	0.9%	1.5%	1.0%	1.9%

### 39 BUSINESS TAXES AND SURCHARGES

	The Group		The Company	
	2004 RMB million	2003 RMB million	2004 RMB million	2003 RMB million
Business tax	673	176	447	121
City construction tax	11	10	5	8
Education surcharge	8	5	4	3
Total	<b>692</b>	<b>191</b>	<b>456</b>	<b>132</b>

## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

**40 PROFIT FROM OTHER OPERATIONS**

	The Group		The Company	
	2004 RMB million	2003 RMB million	2004 RMB million	2003 RMB million
Sales commission income	–	146	–	125
General aviation income	–	3	–	1
Ground services income	112	79	110	79
Others	23	98	78	48
<b>Total</b>	<b>135</b>	<b>326</b>	<b>188</b>	<b>253</b>

**41 FINANCIAL EXPENSES**

	The Group		The Company	
	2004 RMB million	2003 RMB million	2004 RMB million	2003 RMB million
Interest expenses incurred	734	907	586	792
Less: Capitalised interest expenses	23	83	23	83
Net interest expense	711	824	563	709
Interest income	(34)	(13)	(17)	(8)
Net foreign exchange loss	20	164	14	170
Bank charges	30	21	25	17
<b>Total</b>	<b>727</b>	<b>996</b>	<b>585</b>	<b>888</b>

Net foreign exchange loss arose mainly from the Group's and the Company's Japanese Yen denominated finance lease obligations due to fluctuations in the exchange rate of Japanese Yen.

**42 INVESTMENT INCOME**

	The Group		The Company	
	2004 RMB million	2003 RMB million	2004 RMB million	2003 RMB million
<b>Equity investment income accounted for</b>				
Under cost method	14	17	–	–
Under equity method	49	45	224	267
<b>Total</b>	<b>63</b>	<b>62</b>	<b>224</b>	<b>267</b>

There are no major restrictions on the remittance of the Group's and the Company's investment returns.



Notes to the Financial Statements (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

**43 NON-OPERATING INCOME**

	The Group		The Company	
	2004 RMB million	2003 RMB million	2004 RMB million	2003 RMB million
Gain on sale of fixed assets	50	22	40	3
Written off of expired sales in advance of carriage	35	–	35	–
Others	41	21	31	15
Total	126	43	106	18

**44 NON-OPERATING EXPENSES**

	The Group		The Company	
	2004 RMB million	2003 RMB million	2004 RMB million	2003 RMB million
Loss on sale of fixed assets	44	41	57	–
Donations	9	2	–	–
Technical fee	30	–	–	–
Others	44	28	1	24
Total	127	71	58	24

**45 INCOME TAX**

	The Group		The Company	
	2004 RMB million	2003 RMB million	2004 RMB million	2003 RMB million
Provision for income tax	197	47	94	–
Deferred taxation (Note 33)	(110)	(652)	(118)	(672)
	87	(605)	(24)	(672)

## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 46 RELATED PARTIES AND RELATED PARTY TRANSACTIONS

#### (a) Related party with controlling relationship

Name of company:	China Southern Air Holding Company
Registered address:	No. 278, Ji Chang Road, Guangzhou, Guangdong Province.
Major business:	Management of the companies' operations within the Group and the sale of products
Relation with the Company:	The ultimate holding company
Nature of ownership:	State-owned
Legal representative:	Liu Shao Yong
Registered capital:	RMB 2,198,980,000

At 31 December, 2004 and 2003, CSAHC held 2,200,000,000 Legal Person Shares of the Company totalling RMB 2,200,000,000.

#### (b) Relationship between the Company and related parties without controlling relationships

##### (i) *Companies that are under the control of CSAHC, i.e. subsidiaries of CSAHC:*

Southern Airlines (Group) Import and Export Trading Company  
 Zhongyuan Airlines Company  
 Southern Airlines (Group) Economic Development Company  
 Nanlung Travel & Express (H.K.) Ltd.  
 Shenzhen Baiyun Air Service Co. Ltd.  
 Southern Airlines Group Finance Company Limited  
 Xinjiang Airlines Company  
 China Northern Airlines Company

##### (ii) *Company that is under the significant influence of CSAHC:*

Shenzhen Air Catering Company Limited

##### (iii) *Jointly controlled entities of the Group:*

Guangzhou Aircraft Maintenance Engineering Company Limited  
 MTU Maintenance Zhuhai Co. Ltd.  
 China Postal Airlines Limited

##### (iv) *Associated companies of the Group:*

Hong Kong Business Aviation Centre Company Limited  
 Sichuan Airlines Corporation Limited



Notes to the Financial Statements (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

**46 RELATED PARTIES AND RELATED PARTY TRANSACTIONS** (cont'd)

(c) The related party transactions carried out in during the year were as follows:

	Notes	2004 RMB million	2003 RMB million
<b>Expenses</b>			
Handling charges	(1)	33	27
Wet lease rentals	(2)	–	6
Sundry aviation supplies	(3)	66	43
Sales commission expense	(4)	2	5
Air catering expense	(5)	50	28
Repairing charges	(6)	579	347
Staff housing allocation benefits	(7)	85	85
Lease charges for land and buildings	(8)	18	15
Trademark	(9)	–	–
<b>Income</b>			
Interest income	(10)	4	3
<b>Others</b>			
Short-term loans	(11)	–	166
Refund of medical benefit payments	(12)	–	58
CNA/XJA Acquisitions	(13)	15,398	–

Notes:

- (1) Handling charges represent fees payable to Southern Airlines (Group) Import and Export Trading Company in connection with the procurement of aircraft and flight equipment on the Group's behalf. Handling charges are calculated based on a fixed percentage of the procurement value by reference to market rates. The fees are usually paid by the end of the following month.
- (2) Pursuant to a wet lease agreement effective October 2002, the Group paid rentals to Xinjiang Airlines in respect of one Boeing 757-200 aircraft. The wet lease rentals are calculated by reference to market rates. The rentals payable were settled on the 14th of the following month. The wet lease agreement was terminated in April 2003.
- (3) Sundry aviation supplies represent purchases of sundry aviation supplies from Southern Airlines (Group) Economic Development Company. Prices are determined by reference to market prices. The payable amount is generally settled by the end of the following month.
- (4) Sales commission expenses represent commission payable to Nanlung Travel & Express (H.K.) Ltd., South China International and Aviation and Travel Services Company and Shenzhen Baiyun Air Services Co. Ltd. in connection with air tickets sold by these sales agents on the Group's behalf. The commission rates are based on the rates stipulated by the CAAC. The sales commission expense payable is offset directly against the sales proceeds receivable from these sales agents.
- (5) Air catering expenses represent fees payable to Shenzhen Air Catering Company Limited for providing inflight meals to the Group. CSAHC holds a 33% equity interest in the company. Prices are determined by reference to market prices. The payable amount is usually settled by the end of the following month.

## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 46 RELATED PARTIES AND RELATED PARTY TRANSACTIONS (cont'd)

#### (c) The principal related party transactions carried out in during the year were as follows: (cont'd)

Notes: (cont'd)

- (6) Repair charges represent fees payable to Guangzhou Aircraft Maintenance Engineering Company Limited and MTU Maintenance Zhuhai Co. Ltd. in connection with aircraft repairs and maintenance services rendered to the Group. Fees are charged based on market prices. For the year, repair fees amounting to RMB 579,000,000 were eliminated in applying the proportional consolidation method.
- (7) Staff housing allocation benefits payable to CSAHC represent the difference between the cost of the quarters sold to the employees of the Group and the proceeds from sales of these quarters by CSAHC. The payment is determined based on number of quarters and the construction cost of the housing sold over the sales prices, and is payable in accordance with the related agreement.
- (8) Lease charges for land and buildings represent rentals payable to CSAHC by the Group under certain lease agreements in respect of certain land and buildings of CSAHC. The rentals are determined based on market rents. The rentals payments are due in June and December of each year.
- (9) The Company and CSAHC have entered into a 10-year trademark licence agreement dated 22 May, 1997, pursuant to which CSAHC acknowledged that the Company has the right to use the name "China Southern" and "China Southern Airlines" in both Chinese and English, and granted to the Company a renewable royalty-free licence to use the kapok logo on a world-wide basis in connection with the Company's airline and airline-related businesses. Unless CSAHC gives written notice of termination three months before the expiration of the agreement, the agreement will be automatically extended for another 10-year term.
- (10) Interest income represents the interest received from deposits placed with SA Finance by the Group (Note 5). The applicable interest rate is determined in accordance with the deposit rate published by the People's Bank of China. Interest income is received quarterly. Please refer to Note 46 (d) for the balance of deposits at the end of each year.
- (11) As at 31 December, 2003, CSAHC made short-term cash advances to the Group. These advances were unsecured, interest free and repayable on demand. The cash advances were fully settled during the year.
- (12) The Group provides retirees with medical benefits, transportation subsidies and other welfare facilities. Prior to 2002, the Group paid a fixed annual fee to CSAHC in return for CSAHC providing such benefits to the retired employees of the Group. With effect from 1 January, 2002, such arrangement was terminated. During 2003, CSAHC refunded to the Group the difference between the aggregate fixed annual fees received from the Group and the aggregate cost of services incurred by CSAHC.
- (13) As disclosed in Note 1 to the financial statements, on 31 December, 2004 the Company acquired the airline operations and certain related assets of CNA and XJA at a total consideration of RMB15,398 million, which was partly satisfied by assumption of debts and liabilities of CNA and XJA totalling RMB13,439 million outstanding as at that date. The remaining consideration payable of RMB1,959 million will be satisfied in cash.

In addition to the above, certain business undertakings of CSAHC provided transportation, hotel and other services to the Group during the year. The total amount involved was not material to the results of the Group for the year.



Notes to the Financial Statements (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

**46 RELATED PARTIES AND RELATED PARTY TRANSACTIONS** (cont'd)

**(d) The major balances with related parties are summarised as follows:**

	Relationship	2004 RMB million	2003 RMB million
Cash at bank and on hand			
SA Finance	Affiliated company	406	371
Trade receivables			
Nanlung Travel & Express (H.K.) Ltd.	Affiliated company	52	54
Golden Royal International Travel Ltd.	Affiliated company	–	8
Other receivables			
Southern Airlines (Group) Import and Export Traveling Company	Affiliated company	15	17
Guangzhou Aircraft Maintenance Engineering Company Limited	Jointly controlled entity	22	–
Trade payables			
Southern Airlines (Group) Import and Export Trading Company	Affiliated company	838	693
Guangzhou Aircraft Maintenance Engineering Company Limited	Jointly controlled entity	118	156
Xinjiang Airlines Company	Affiliated company	–	81
China Northern Airlines Company	Affiliated company	–	337
Southern Airlines (Group) Economic Development Company	Affiliated company	3	–
Other payables			
China Southern Air Holding Company	Ultimate holding company	1,990	166
Accrued expenses			
MTU Maintenance Zhuhai Co. Ltd.	Jointly controlled entity	138	47

**(e) Guarantees provided by related parties and other contingent liabilities:**

- (i) Other than the guarantees given by CSAHC and SA Finance to banks in respect of certain loans of the Group (Note 20 and Note 29), there were no guarantees given to banks by related parties.
- (ii) A demerger agreement dated 25 March, 1995 (as amended by amendment no. 1 dated 22 May, 1997) (the “Demerger Agreement”) was entered into between the CSAHC and the Company for the purpose of defining and allocating the assets and liabilities between CSAHC and the Company. Under the Demerger Agreement, CSAHC and the Company have agreed to indemnify the other party against, among other things, claims, liabilities and expenses incurred by the other party but relating to the businesses, assets and liabilities held or assumed by CSAHC or the Company pursuant to the Demerger Agreement. From the date of the Demerger Agreement to the date on which these financial statements are authorised for issue, there have been no incidences of compensation in respect of claims, assets or liabilities held or assumed by CSAHC or the Company.

## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 46 RELATED PARTIES AND RELATED PARTY TRANSACTIONS (cont'd)

#### (e) Guarantees provided by related parties and other contingent liabilities: (cont'd)

(iii) The Company leases from CSAHC certain land in Guangzhou and certain land and buildings in Wuhan, Haikou and Zhengzhou. The Group has significant investments in buildings and other leasehold improvements located on such land. However, such land and buildings lack adequate documentation evidencing the CSAHC rights thereto.

Pursuant to a compensation agreement dated 22 May, 1997, CSAHC agrees to indemnify the Group against any loss or damage caused by any challenge or interference with the Group's use of any of its land and buildings.

The directors of the Company are of the opinion that the above transactions with related parties were entered into in the normal course of business and on normal commercial terms or in accordance with the agreements governing such transactions.

### 47 SEGMENTAL INFORMATION

The Group engages in a single operation, i.e. the provision of airline services. Geographic information about the Group's profit from principal operations are as follows:

	Domestic RMB million	Hong Kong & Macau RMB million	International (Note) RMB million	Total RMB million
<b>2004</b>				
Net revenue from principal operations	18,582	1,201	4,411	24,194
Less: Cost of principal operations	14,825	932	3,539	19,296
Business taxes and surcharges	532	34	126	692
<b>Profit from principal operations</b>	<b>3,225</b>	<b>235</b>	<b>746</b>	<b>4,206</b>
<b>2003</b>				
Net revenue from principal operations	13,243	793	3,064	17,100
Less: Cost of principal operations	10,936	699	2,587	14,222
Business taxes and surcharges	156	5	30	191
<b>Profit from principal operations</b>	<b>2,151</b>	<b>89</b>	<b>447</b>	<b>2,687</b>

Note: Mainly routes between the PRC and Asian countries, the United States of America, the Netherlands, Belgium, Australia and France.

The major revenue-earning asset of the Group is its aircraft fleet, most of which is registered in the PRC. Since the Group's aircraft fleet is employed flexibly across its route network, there is no suitable basis for allocating its assets to geographic segments. Substantially all of the Group's non-aircraft identifiable assets are located in the PRC.





## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 48 CONTINGENT LIABILITIES

The Company is involved in a civil litigation (Hong Kong High Court Action No. 515 of 2001) ("Litigation"). According to the writ of summons for the Litigation, New Link Consultants Limited, the plaintiff claimed unspecified damages against the Group (as one of the defendants to the Litigation) for breach of the agreement on the basis of certain evidence proving that United Aero-Supplies System of China, Limited ("UASSC") entered into an agreement with the defendants for exclusive purchase of aviation equipment consigned to UASSC for sale and, that as the defendants failed to perform the agreement, UASSC has the right to compensation. Since UASSC is in the course of its winding up proceedings, all the rights and benefits of UASSC in connection with the claim have been transferred to the plaintiff. Based on the opinion given by the Company's legal advisors, the directors of the Company consider that the Company has a valid defence against the claim and that a provision for such claim and/or the associated legal costs is not required.

### 49 COMMITMENTS

#### (i) Capital commitments

As at 31 December, 2004, the Group and the Company had capital commitments as follows:

	The Group		The Company	
	2004 RMB million	2003 RMB million	2004 RMB million	2003 RMB million
Commitments in respect of aircraft and related equipment:				
– authorised and contracted for	11,776	10,615	10,121	7,739
– authorised but not contracted for	13,571	–	13,571	–
	25,347	10,615	23,692	7,739
Commitments in respect of investments in the Guangzhou new airport:				
– authorised and contracted for	110	617	110	617
– authorised but not contracted for	714	1,455	714	1,455
	824	2,072	824	2,072
Other commitments:				
– authorised and contracted for	132	257	117	30
– authorised but not contracted for	724	992	200	229
	856	1,249	317	259
	27,027	13,936	24,833	10,070

## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 49 COMMITMENTS (cont'd)

#### (i) Capital commitments (cont'd)

As at 31 December, 2004, the Group had on order five Boeing 737-700 aircraft, six Airbus 319-100 aircraft, fifteen Airbus 320-200 aircraft, two Airbus 321-200 aircraft, four Airbus 330-200 aircraft, one Embraer ERJ-145 aircraft and certain flight equipment, scheduled for deliveries in 2005 to 2007. Deposits of RMB4,640 million have been made towards the purchase of these aircraft and related equipment. As at 31 December, 2004, the approximate total future payments, including estimated amounts for price escalation through anticipated delivery dates for these aircraft and related equipment are as follows:

	The Group RMB million	The Company RMB million
Payments due:		
2005	8,748	7,093
2006	2,996	2,996
2007	32	32
	11,776	10,121

#### (ii) Operating lease commitments

The Group's and the Company's commitments under non-cancellable aircraft and flight equipment operating leases were as follows:

	The Group		The Company	
	2004 RMB million	2003 RMB million	2004 RMB million	2003 RMB million
Payments due:				
Within one year	1,761	1,483	1,489	1,194
In the second year	1,622	1,411	1,418	1,169
In the third year	1,562	1,144	1,376	969
After the third year	7,805	4,082	7,568	3,719
	12,750	8,120	11,851	7,051

#### (iii) Investing commitments

As at 31 December, 2004, the Group and the Company committed to making capital contributions of approximately RMB181 million and RMB83 million respectively (2003: nil and RMB446 million respectively) towards its subsidiaries and jointly controlled entities.



Notes to the Financial Statements (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

**50 PRINCIPAL SUBSIDIARIES, ASSOCIATED COMPANIES, AND JOINTLY CONTROLLED ENTITIES**

The particulars of the Company's principal subsidiaries, and the Group's associated companies and jointly controlled entities as at 31 December, 2004 are as follows:

**(i) Principal subsidiaries**

Name of company	Place and date of establishment/ operation	Attributable/ equity interest		Issued/ registered capital (Note a)	Principal activities
		Direct %	Indirect %		
Guangxi Airlines Company Limited	PRC 28 April, 1994	60	–	170,900,000	Airline
China Southern (Group) Shantou Airlines Company Limited	PRC 20 July, 1993	60	–	280,000,000	Airline
Zhuhai Airlines Company Limited	PRC 8 May, 1995	60	–	250,000,000	Airline
Xiamen Airlines Company Limited	PRC 11 August, 1984	60	–	700,000,000	Airline
Guizhou Airlines Company Limited	PRC 12 November, 1991	60	–	80,000,000	Airline
Guangzhou Nanland Air Catering Company Limited (Note b)	PRC 21 November, 1989	51	–	55,980,000	Air catering
Guangzhou Aviation Hotel	PRC 8 January, 1997	90	–	63,290,000	Hotel operation
Southern China International Aviation & Travel Services Company	PRC 11 May, 1992	90	–	2,100,000	Travel services
Guangzhou Baiyun International Logistic Company Limited	PRC 23 July, 2002	61	–	20,000,000	Logistic operations
Zhuhai Xiang Yi Aviation Technology Company Limited (Note b)	PRC 10 July, 2002	51	–	USD29,800,000	Provision of flight simulation training services
CSN - ETC e-commerce Limited	PRC 10 February, 2003	51	–	5,880,000	Provision of internet service
China Southern West Australian Flying College Pty Limited	Australia 26 January, 1971	65	–	AUD100,000	Pilot training services
CZ Flamingo Limited	Cayman Islands 8 December, 1993	100	–	USD1,000	Aircraft leasing
CZ Skylark Limited	Cayman Islands 17 November, 1993	100	–	USD1,000	Aircraft leasing
CZ Kapok Limited	Cayman Islands 26 October, 1993	100	–	USD1,000	Aircraft leasing
CSA-I Limited	Cayman Islands 1 September, 1993	100	–	USD1,000	Aircraft leasing

## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

**50 PRINCIPAL SUBSIDIARIES, ASSOCIATED COMPANIES, AND JOINTLY CONTROLLED ENTITIES** (cont'd)**(i) Principal subsidiaries** (cont'd)

Name of company	Place and date of establishment/ operation	Attributable/ equity interest		Issued/ registered capital (Note a)	Principal activities
		Direct %	Indirect %		
CZ93B Limited	Cayman Islands 11 May, 1993	100	–	USD1,000	Aircraft leasing
CZ97A Limited	Cayman Islands 2 January, 1997	100	–	USD1,000	Aircraft leasing
Zhong Yuan 99A Limited	Cayman Islands 15 February, 1999	100	–	USD1,000	Aircraft leasing
CXA92A Limited	Cayman Islands 3 August, 1992	–	60	USD1,000	Aircraft leasing
CXA93A Limited	Cayman Islands 1 July, 1993	–	60	USD1,000	Aircraft leasing
CXA95B Limited	Cayman Islands 7 July, 1995	–	60	USD1,000	Aircraft leasing
CXA95C Limited	Cayman Islands 16 October, 1995	–	60	USD1,000	Aircraft leasing
CXA98A Limited	Cayman Islands 20 March, 1998	–	60	USD1,000	Aircraft leasing
Xiamen Aviation Supplies Limited	PRC 30 July, 1997	–	60	8,560,000	Aviation supplies
Xiamen Aviation Development Company Limited	PRC 18 February, 1998	–	54	5,000,000	Hotel management
Xiamen Air Holidays Limited	Hong Kong 28 April, 1994	–	54	HK\$3,000,000	Travel servicing
Xiamen Macau Holidays Limited (Note c)	Macau 11 May, 1995	–	27.5	MOP1,000,000	Travel servicing
Shantou Hua Kang Air Catering Company Ltd (Note c)	PRC 22 June, 1994	–	42	10,000,000	Air catering
Xinjiang Aviation Ground Service Company Limited	PRC 27 May, 2002	60	–	15,000,000	Airport ground services
Xinjiang Civil Aviation Property Management Limited	PRC 12 December, 2002	51.8	–	251,332,832	Utility services
China Northern Airlines Aircraft Maintenance Co., Ltd.	PRC 8 November, 1997	75	–	USD3,800,000	Aircraft repair and maintenance services
Xiamen Aviation Property Development Company	PRC 22 June, 1993	–	60	5,000,000	Property development



Notes to the Financial Statements (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

**50 PRINCIPAL SUBSIDIARIES, ASSOCIATED COMPANIES, AND JOINTLY CONTROLLED ENTITIES** (cont'd)

(i) **Principal subsidiaries** (cont'd)

Name of company	Place and date of establishment/ operation	Attributable/ equity interest		Issued/ registered capital (Note a)	Principal activities
		Direct %	Indirect %		
Guangzhou Air Cargo Company Limited	PRC 31 March, 2004	70	–	238,000,000	Cargo services
Zhuhai Aviation Advertising Company Limited (Note d)	PRC 3 August, 1995	–	36	1,500,000	Advertising services
Guangzhou Baiyun International Express Customs Supervision Co. Ltd. (Note d)	PRC 28 July, 2003	–	55	5,000,000	Logistic operations

Notes:

- (a) Expressed in RMB, unless otherwise stated.
- (b) These subsidiaries are Sino-foreign equity joint venture companies.
- (c) The Company holds over 51% equity interest in these companies through its non-wholly owned subsidiaries. The Company has a controlling interest in these companies through these non-wholly owned subsidiaries. These companies are therefore consolidated in the Group's consolidated financial statements.
- (d) Notwithstanding that the Group holds over 50% of the registered capital of these companies, the Company did not consolidate these companies into its consolidated financial statements for the year because their assets, liabilities and results of operations were not significant and had no significant effect on the Group's consolidated financial statements. Accordingly, the Group accounted for the investments in these companies under the cost method.

Other than those stated in Note (d) above, the subsidiaries were accounted for under the equity method in the Group's consolidated financial statements during the year.

## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 50 PRINCIPAL SUBSIDIARIES, ASSOCIATED COMPANIES, AND JOINTLY CONTROLLED ENTITIES (cont'd)

#### (ii) Principal associated companies and jointly controlled entities

Name of company	Place and date of establishment/ operation	Attributable/ equity interest		Issued/ registered capital (Note a)	Principal activities
		Direct %	Indirect %		
Guangzhou Aircraft Maintenance Engineering Company Limited (Note b)	PRC 28 October, 1989	50	–	US\$27,500,000	Provision of aircraft repair and maintenance services
Southern Airlines Group Finance Company Limited	PRC 28 June, 1995	32	15.42	424,330,000	Provision of financial services
Hainan Phoenix Information System Limited	PRC 12 March, 1994	45	–	US\$16,360,000	Provision of ticket reservation system services
Hong Kong Business Aviation Centre Company Limited	Hong Kong 7 January, 1998	20	–	HK\$1,000,000	Provision of private flight logistic services
MTU Maintenance Zhuhai Co. Ltd. (Note b)	PRC 6 April, 2001	50	–	US\$63,100,000	Provision of engine repair and maintenance services
China Postal Airlines Limited (Note b)	PRC 25 November, 1996	49	–	306,000,000	Airline
Beijing Southern Ground Services Company Limited (Note b)	PRC 1 April, 2004	50	–	18,000,000	Airport Ground service support
Southern Airlines Advertising Company	PRC 3 March, 1994	45	–	5,000,000	Aviation advertising
Sichuan Airlines Corporation Limited	PRC 28 August, 2002	39	–	350,000,000	Airline
Zhuhai Air Express Co. Ltd. (Note c)	PRC 26 February, 1997	–	18	3,000,000	Air express services
Guilin Guangsheng Industrial Development Co. Ltd.	PRC 18 January, 2000	–	18	2,100,000	Wholesale and retailing
Civil Aviation Cares of Xiamen Ltd.	PRC 14 September, 2001	–	17.1	2,000,000	Computer hardware and software services



Notes to the Financial Statements (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

**50 PRINCIPAL SUBSIDIARIES, ASSOCIATED COMPANIES, AND JOINTLY CONTROLLED ENTITIES (cont'd)**

**(ii) Principal associated companies and jointly controlled entities (cont'd)**

Notes:

- (a) Expressed in RMB, unless otherwise stated.
- (b) These are jointly controlled entities. They were proportionately consolidated in the Group's consolidated financial statements.
- (c) The results of the operations of these companies were not significant and had no significant effect on the Group's consolidated financial statements. Accordingly, the Group accounted for the investments in these companies under the cost method.

Other than those stated in Note (c) above, the associated companies were accounted for under the equity method in the Group's consolidated financial statements for the year ended 31 December, 2004.

**51 EXTRAORDINARY GAINS AND LOSSES**

In accordance with the requirements of "Questions and Answers on the Preparation of Information Disclosures of Companies Issuing Public Shares No.1 - Extraordinary Gains and Losses" (revised 2004), the extraordinary gains and losses of the Group are set out below:

	2004 RMB million	2003 RMB million
Extraordinary gains and losses for the year		
Refund of deferred taxation (Note 33)	-	516
Refund of medical benefit payments (Note 46(c))	-	58
Loss on sale of fixed assets	6	(19)
Written off of expired sales in advance of carriage	35	-
Technical fee	(30)	-
Various subsidies	-	4
Net of other non-operating income and expenses other than impairment loss and loss on sale of fixed assets	-	(13)
Taxation effect of the above items	(2)	-
<b>Total</b>	<b>9</b>	<b>546</b>

## Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)

### 52 POST BALANCE SHEET EVENTS

In January 2005, the Company, as a lessee, entered into an agreement with an independent lessor for operating leases of nine Boeing 737-800 aircraft for a term of seven years with total future payments totalling approximately RMB1,721 million, scheduled for deliveries in 2005 and 2006.

In January 2005, China Aviation Supplies Import and Export Corporation, as a sole importing agent, entered into, on behalf of several PRC airlines including the Group, a general purchase agreement with the Boeing Company for the import of Boeing B7E7 aircraft. The Company, being one of the ultimate users for thirteen of the Boeing B7E7 aircraft, endorsed the general purchase agreement. The Company is currently in negotiation with the Boeing Company regarding the purchase agreements on such aircraft.

In March 2005, the Company, as a lessee, entered into another agreement with an independent lessor for operating leases of a total of twenty-five aircraft comprising five Boeing 737-700 aircraft, five Boeing 737-800 aircraft, five Airbus 320-200 aircraft and ten Airbus 321-200 aircraft with scheduled deliveries in 2006 and 2007. The term of the lease ranges from ten to twelve years with total future lease payments totally approximately RMB8,243 million.

In April 2005, the Company entered into a purchase agreement with Airbus SNC for the purchase of five Airbus A380 aircraft, scheduled for deliveries in 2007 to 2010.